The Economic Cooperation Organization
Trade and Development Bank

Financial Statements
As at and for the year ended 31 December 2018
With Independent Auditors’ Report Thereon

27 June 2019

This report contains the “Independent Auditors’ Report” comprising 3 pages and; the “Financial statements and their explanatory notes” comprising 70 pages.

The Economic Cooperation Organization Trade and Development Bank

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KPMG

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of the Economic Cooperation Organization Trade and Development Bank,

Opinion

We have audited the financial statements of The Economic Cooperation Organization Trade and Development Bank ("the Bank") which comprise the statement of financial position as at 31 December 2018, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as at 31 December 2018, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISA"s). 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 the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with 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 has no realistic alternative but to do so.

Those charged with governance are 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 those charged with governance 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.

KPMG Bağımsız Denetim ve Serbest Muhasebeci Mali Müşavirlik A.Ş.
A member firm of KPMG International Cooperative

Alper Güvenç
Partner

27 June 2019
İstanbul, Turkey

THE ECONOMIC COOPERATION ORGANIZATION TRADE AND DEVELOPMENT BANK

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2018

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

	Notes	31 December 2018	31 December 2017
ASSETS			
Loans and advances to banks	13	314,243	341,017
Loans and advances to customers	14	133,425	129,798
Investment securities	15	22,716	14,068
Derivative financial instruments	12	800	663
Property and equipment	16	7,658	7,735
Investment property	17	1,743	1,762
Intangible assets	18	70	115
Other assets	19	1,104	353
Total assets		**481,759**	**495,511**
LIABILITIES			
Deposits from banks	20	92,692	117,228
Derivative financial instruments	12	444	732
Employee benefits	21	3,310	3,073
Other liabilities	22	806	1,132
Total liabilities		**97,252**	**122,165**
EQUITY			
Share capital	23.1	323,710	319,430
Revaluation reserves	23.2	(3)	49
Other reserves	23.3	53,867	44,096
Retained earnings	23.3	6,933	9,771
Total equity		**384,507**	**373,346**
Total liabilities and equity		**481,759**	**495,511**

The accompanying notes form an integral part of these financial statements.

THE ECONOMIC COOPERATION ORGANIZATION TRADE AND DEVELOPMENT BANK

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

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

Profit or Loss	**Notes**	**31 December 2018**	**31 December 2017**
Interest income	24	14,470	13,637
Interest expense	24	(846)	(920)
Net interest income before impairment for credit risks		**13,624**	**12,717**
Impairment (loss)/gain for credit risks, net	9.2.6	(2,030)	-
Net interest income after impairment for credit risks		**11,594**	**12,717**
Fee and commission income	25	518	346
Fee and commission expense	25	(3)	(4)
Net fee and commission income		**515**	**342**
Net trading income		1,107	957
Other operating income	26	58	92
Total operating income		**13,274**	**14,108**
Personnel expenses	27	(3,193)	(3,642)
Other administrative expenses	27	(407)	(493)
Depreciation and amortization	16, 17, 18, 27	(165)	(202)
Total operating expenses		**(3,765)**	**(4,337)**
Net profit for the period		**9,509**	**9,771**
Other comprehensive income:			
Items that are or may be reclassified subsequently to profit or loss			
Fair value change on available-for-sale debt instruments		-	(32)
Re-measurement gain/(loss) on defined benefit plans		(3)	-
Other comprehensive income		**(3)**	**(32)**
Total comprehensive income		**9,506**	**9,739**

The accompanying notes form an integral part of these financial statements.

THE ECONOMIC COOPERATION ORGANIZATION TRADE AND DEVELOPMENT BANK

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2018

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

	Notes	Share Capital	Revaluation reserves	Other reserves	Retained earnings	Total
Balance at 1 January 2017		**315,150**	**81**	**36,622**	**7,474**	**359,327**
Total comprehensive income						
Profit for the period		-	-	-	9,771	9,771
Other comprehensive income						
Fair value gains on available-for-sale financial assets		-	(32)	-	-	(32)
Total comprehensive income		**-**	**(32)**	**-**	**9,771**	**9,739**
Transactions with members of the Bank						
Contributions and distributions						
Increase in paid-in share capital	23.1	4,280	-	-	-	4,280
Appropriation of profit		-	-	7,474	(7,474)	-
Total contributions and distributions		**4,280**	**-**	**7,474**	**(7,474)**	**4,280**
Balance at 31 December 2017		**319,430**	**49**	**44,096**	**9,771**	**373,346**
Balance at 31 December 2017		**319,430**	**49**	**44,096**	**9,771**	**373,346**
Adjustment on initial application of IFRS 9	28	-	(49)	-	(2,576)	(2,625)
Restated balance at 1 January 2018		**319,430**	**-**	**44,096**	**7,195**	**370,721**
Total comprehensive income						
Profit for the period		-	-	-	9,509	9,509
Other comprehensive income						
Re-measurement gain/(loss) on defined benefit plans	23.2	-	(3)	-	-	(3)
Total comprehensive income		**-**	**(3)**	**-**	**9,509**	**9,506**
Transactions with members of the Bank						
Contributions and distributions						
Increase in paid-in share capital	23.1	4,280	-	-	-	4,280
Appropriation of profit	23.3	-	-	9,771	(9,771)	-
Total contributions and distributions		**4,280**	**-**	**9,771**	**(9,771)**	**4,280**
Balance at 31 December 2018		**323,710**	**(3)**	**53,867**	**6,933**	**384,507**

The accompanying notes form an integral part of these financial statements.

THE ECONOMIC COOPERATION ORGANIZATION TRADE AND DEVELOPMENT BANK

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2018

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

	Notes	31 December 2018	31 December 2017
Cash flows from operating activities:			
Net profit for the period		9,509	9,771
Adjustments for:			
Depreciation and amortization	16, 17, 18, 27	165	202
Net impairment loss/(gain) on financial assets	9.2.6	2,030	-
Accrued interest and expenses		23	88
Measurement of derivative financial instruments at fair value	12	(425)	(2,035)
Provision for employee benefit obligations		332	364
Other non-cash items		951	(3,414)
Cash flows from operating activities before changes in operating assets and liabilities		**12,585**	**4,976**
Changes in:			
Loans and advances to banks		27,877	21,346
Loans and advances to customers		(5,661)	(19,147)
Other assets		(890)	(227)
Employee benefits		(252)	(198)
Deposits from banks		(24,597)	8,098
Other liabilities		39	651
Net cash from/(used in) operating activities		**9,101**	**15,499**
Cash flows from investing activities:			
Acquisition of investment securities		(9,812)	(4,422)
Proceeds from redemption/sale of investment securities		1,076	6,582
Acquisition of property and equipment	16	(21)	(10)
Acquisition of intangible assets	18	(3)	(7)
Net cash from/(used in) investing activities		**(8,760)**	**2,143**
Cash flows from financing activities:			
Increase in paid-in share capital	23.1	4,280	4,280
Net cash from/(used in) financing activities		**4,280**	**4,280**
Net increase/(decrease) in cash and cash equivalents		**4,621**	**21,922**
Cash and cash equivalents at 1 January		110,712	85,599
Effects of exchange-rate changes on cash and cash equivalents		(1,174)	3,191
Cash and cash equivalents at the end of the period	**11**	**114,159**	**110,712**

The accompanying notes form an integral part of these financial statements.

A. BASIS OF PREPARATION

NOTE 1 – REPORTING ENTITY

The Economic Cooperation Organization Trade and Development Bank ('the Bank' or 'ETDB') is a multilateral development finance institution established under the Articles of Agreement ('the Agreement') with the mission; to promote and facilitate private and public sector investment, cooperation, development and job creation in member states through joint programs, to foster the growth of intra-regional trade, to contribute to the economic and social development for the welfare of the people in member states and promote good governance and environment consciousness in all efforts and projects.

The status, privileges and immunities of the Bank and persons connected therewith in the Republic of Turkey are defined in the Headquarters Agreement between the ECO Trade and Development Bank and the Government of the Republic of Turkey ('the Headquarters Agreement') signed on 27 December 2006. The Headquarters Agreement was ratified by the Grand National Assembly and the President of the Republic of Turkey by Law No. 5638 and was published in Official Gazette dated 3 July 2007 with No. 26571.

The headquarters address of the Bank is "Bomonti Business Center, Cumhuriyet Mah. Silahşör Caddesi, Yeniyol Sk. No: 8 Kat: 14, 34380 Bomonti Şişli - İstanbul Turkey".

As of 31 December 2018, the number of employees of the Bank is 39 (31 December 2017: 44).

NOTE 2 – BASIS OF ACCOUNTING

These financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards ('IFRS'). The Management Committee of the Bank decided to submit the financial statements for the year ended 31 December 2018 to the Board of Directors on 29 May 2019.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgment or complexity or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 4. Details of the Bank's accounting policies, including changes during the year, are included in Notes 6 and 7.

NOTE 3 – FUNCTIONAL AND PRESENTATION CURRENCY

In accordance with Article 4 of the Agreement, the unit of account of the Bank is ECO Unit ('EU') that is equivalent to one Special Drawing Right ('SDR') of the International Monetary Fund ('IMF'). As per Article 11 of the Agreement, the Bank's foreign currency facilities shall be denominated and payable in the currencies of which the SDR is composed or in EU. Accordingly, the Bank's 'functional currency' is the SDR and all transactions are recorded in SDR. The Bank's 'presentation currency' is EU.

NOTE 4 – USE OF JUDGEMENTS AND ESTIMATES

In preparing these financial statements, management has made judgements, estimates and assumptions that affect the application of the Bank's accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to estimates are recognised prospectively.

4.1. Judgements

Applicable to 2018 only

Information about judgements made in applying accounting policies that have the most significant effects on the amounts recognised in the financial statements is included in the following notes.

- Note 7.7.2. – classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding.
- Note 9.2.6. – impairment of financial instruments: assessment of whether credit risk on the financial asset has increased significantly since initial recognition, selection and approval of models used to measure expected credit losses ('ECL').

4.2. Assumptions and estimation uncertainties

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2018 is included in the following notes.

Applicable to 2018 only

- Note 9.2.6. – impairment of financial instruments: determining inputs into the ECL measurement model.

Applicable to 2018 and 2017

- Note 10. – determination of the fair value of financial instruments with significant unobservable inputs.
- Note 7.19. – measurement of defined benefit obligations: key actuarial assumptions.

B. ACCOUNTING POLICIES

NOTE 5 – BASIS OF MEASUREMENT

The financial statements have been prepared on a historical cost basis, except for the following material items:

- Derivative financial instruments: Fair value.
- Available-for-sale financial assets (applicable before 1 January 2018): Fair value.

NOTE 6 – CHANGES IN ACCOUNTING POLICIES

The Bank has initially adopted IFRS 9 (Note 6.1.) and IFRS 15 (Note 6.2.) from 1 January 2018.

A number of other new standards are also effective from 1 January 2018 but they do not have a material effect on the Bank's financial statements.

Due to the transition method chosen by the Bank in applying IFRS 9, comparative information throughout these financial statements has not generally been restated its requirements.

The adoption of IFRS 15 did not impact the timing or amount of fee and commission income from contracts with customers and the related assets and liabilities recognised by the Bank. Accordingly, the impact on the comparative information is limited to new disclosure requirements.

The effect of initially applying these standards is mainly attributed to the following:

- an increase in impairment losses recognised on financial assets (Note 13, 14, 15 and 28);
- additional disclosures related to IFRS 9 (Note 9.2., 13, 14, 15 and 28).

Except for the changes below, the Bank has consistently applied the accounting policies as set out in Note 7 to all periods presented in these financial statements.

The Bank has not adopted early any other standard, interpretation or amendment that has been issued but is not yet effective.

6.1. IFRS 9 Financial Instruments

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 Financial Instruments: Recognition and Measurement. The requirements of IFRS 9 represent a significant change from IAS 39. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

The Bank has adopted consequential amendments to IFRS 7 Financial Instruments: Disclosures that are applied to disclosures about 2018, but have not been applied to the comparative information. The comparative period information repeats that information made in the prior year.

The key changes to the Bank's accounting policies resulting from its adoption of IFRS 9 are summarised below. The transition impact on the accompanying financial statements regarding the first time adoption of IFRS 9 as of 1 January 2018 is presented in transition disclosures (Note 28).

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets:

- measured at amortised cost;
- fair value through other comprehensive income ('FVOCI'); and
- fair value through profit or loss ('FVPL').

IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the previous IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale.

NOTE 6 – CHANGES IN ACCOUNTING POLICIES (Continued)

Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification. For an explanation of how the Bank classifies financial assets under IFRS 9, see Note 7.7.2.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognised in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in other comprehensive income ('OCI'); and
- the remaining amount of change in the fair value is presented in profit or loss.

For an explanation of how the Bank classifies financial liabilities under IFRS 9, see Note 7.7.2.

Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected loss' model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments.

Under IFRS 9, credit losses are recognised earlier than under IAS 39. For an explanation of how the Bank applies the impairment requirements of IFRS 9, see Note 7.7.7. and Note 9.2.6. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in transition disclosures (Note 28).

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below.

Comparative periods generally have not been restated. Difference in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and revaluation reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.

The Bank used the exemption not to restate comparative periods but considering that the amendments made by IFRS 9 to IAS 1 introduced the requirement to present 'interest income calculated using the effective interest rate' as a separate line item in the statement of profit or loss and OCI.

The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.

- The determination of the business model within which a financial asset is held.
- The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVPL.
- For financial liabilities designate as at FVPL, the determination of whether presenting the effects of changes in the financial liability's credit risk in OCI would create or enlarge an accounting mismatch in profit loss.

NOTE 6 – CHANGES IN ACCOUNTING POLICIES (Continued)

If a debt security had low credit risk at the date of initial application of IFRS 9, then the Bank has assumed that credit risk on the asset had not increased significantly since its initial recognition.

For more information and details on the changes and implications resulting from the adoption of IFRS 9, see Note 28.

6.2. IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. In the new standard, total consideration measured will be the amount to which the Company expects to be entitled, rather than fair value and new guidance have been introduced on separating performance obligations for goods and services in a contract and recognition of revenue over time. It replaced IAS 18 Revenue, IAS 11 Construction Contracts and related interpretations.

The Bank initially applied IFRS 15 on 1 January 2018 retrospectively in accordance with IAS 8 without any practical expedients. The timing or amount of the Bank's fee and commission from contracts with customers was not impacted by the adoption of IFRS 15. The impact of IFRS 15 was limited to the new disclosure requirements (Note 25).

The new standard replaces IAS 18 Revenue standard and introduces a new control-based revenue recognition model for contracts with customers.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Except for the changes explained in Note 6, the Bank consistently applied the following accounting policies to all periods presented in these financial statements.

7.1. Foreign currency

Foreign currency transactions are translated into the functional currency using the indicative exchange rates at the dates of the transactions announced by IMF and respective Central Banks.

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the exchange rate at the reporting date. The foreign currency gain or loss on monetary items is the difference between the amortised cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the period, and the amortised cost in the foreign currency translated at the exchange rate at the end of the period.

Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated into the functional currency at the spot exchange rate at the date on which the fair value is determined. Non-monetary items that are measured based on historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

Foreign currency differences arising on the settlement of such transactions and translation are recognized in profit or loss.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Exchange rates used by the Bank at the reporting dates were as follows:

		31 December 2018	31 December 2017
1 EU (SDR) =	United States Dollar	1.3908	1.4241
	Euro	1.2142	1.1875
	Chinese Yuan	9.5311	9.2734
	Japanese Yen	154.141	160.785
	Pound Sterling	1.0955	1.0540
	Turkish Lira	7.3448	5.3738
	Iranian Rial	115,399	51,250
	Pakistani Rupee	193.139	156.989

7.2. Interest

Policy applicable from 1 January 2018

Effective interest rate

Interest income and expense are recognised in profit or loss using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

The effective interest rate of a financial asset or financial liability is calculated on initial recognition of a financial asset or a financial liability. When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired financial assets, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not ECL. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest. For purchased or originated credit-impaired ('POCI') financial assets, a credit adjusted effective interest rate is calculated using estimated future cash flows including ECL.

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Amortised cost and gross carrying amount

The 'amortised cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance (or impairment allowance before 1 January 2018).

The 'gross carrying amount of a financial asset' is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Calculation of interest income and expense

In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired) or to the amortised cost of the liability.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

Presentation

Interest income calculated using the effective interest method presented in the statement of profit or loss and OCI includes only Interest on financial assets and financial liabilities measured at amortised cost.

Interest expense presented in the statement of profit or loss and OCI includes financial liabilities measured at amortised cost.

Policy applicable before 1 January 2018

Effective interest rate

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability 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 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. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts (Note 24).

Amortised cost

The 'amortized cost' of a financial asset or financial liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

Presentation

Interest income and expense are recognized in the statement of profit or loss and other comprehensive income for all instruments measured at amortised cost using the effective interest method.

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

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

7.3. Fees and commission

Fees and commission are generally recognized in the statement of profit or loss and other comprehensive income on an accrual basis over the life of the transaction to which they refer or on cash basis at the time the service is received/the transaction are performed, whichever is more appropriate.

Front-end fees are recorded under other assets and other liabilities when the Bank has the contractual right to receive. Revenue is accrued over the life of the transaction and debited to other liabilities. Loan commitment fees are recognized on a straight-line basis over the commitment period of the respective loan.

Fees and commission expense relates mainly to transaction and service fees, which are expensed as the services are received (Note 25).

7.4. Net trading income

'Net trading income' comprises gains and losses related to derivatives, trading assets and liabilities and include foreign exchange gains and losses.

7.5. Leases

7.5.1. Bank acting as a lessee – Operating leases

The Bank does not have assets acquired under finance lease agreements. Assets held under other leases are classified as operating leases and are not recognised in the statement of financial position.

Payments made under operating leases are recognised in profit loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

The Bank leases two properties under operating leases for the representative offices in Tehran, Islamic Republic of Iran and Karachi, Islamic Republic of Pakistan.

7.5.2. Bank acting as a lessor – Operating leases

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

The Bank holds three properties in its Head-quarters building for lease. Rentals are included in other operating income and maintenance expenses are included in other administrative expenses.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

7.6. Taxation

According to Article 12 of Headquarters Agreement dated 27 December 2006, within the scope of its official activities the Bank, its property, movable and immovable, assets income, of whatever nature such as interests, capital gains, currency gains, profits as well as its operations and transactions, purchase of goods and services shall be exempt from all present and future, direct and indirect taxation and duties, including but not limited to Value Added Tax ('VAT'), income tax, withholding tax, stamp duties, Banking and Insurance Transactions Tax ('BITT'), be it of a local or governmental nature.

7.7. Financial assets and financial liabilities

7.7.1. Recognition and initial measurement

The Bank initially recognizes loans and advances and deposits on the date on which they are originated. All other financial instruments such as derivative financial instruments and investment securities are recognized on the trade date, which is the date on which the Bank becomes a party to the contractual provisions of the instrument.

At initial recognition, the Bank measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are incremental and directly attributable to its acquisition or issue.

7.7.2. Classification

Financial liabilities

The Bank classifies its financial liabilities, other than loan commitments, as measured at amortised cost.

Financial assets

<u>Policy applicable from 1 January 2018</u>

On initial recognition, a financial asset is classified as measured at:
- Fair value through profit or loss;
- Fair value through other comprehensive income; or
- Amortised cost.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVPL:
- 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 ('SPPI').

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

- 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 SPPI.

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 amortised cost or at FVOCI as 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 the Bank’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 realising cash flows through the sale of the assets;
- how the performance of the business model and the financial assets held within that business model are evaluated and reported to the key management personnel;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way in which 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.

The Bank’s assessment of the business model is not performed on the basis of scenarios that are not reasonably expected to occur, such as so-called ‘worst case’ or ‘stress case’ scenarios.

Financial assets that are managed and whose performance is evaluated on a fair value basis are measured at FVPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Assessment of 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.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In assessing whether the contractual flows are SPPI, the Bank considers 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 loans); and
- features that modify consideration of the time value of money.

The Bank assesses whether a loan secured by collateral of the borrower limit the Bank's claim to cash flows of the underlying collateral or not (non-recourse loans). The Bank applies judgement in assessing whether the non-recourse loans meet the SPPI criterion. The Bank typically considers the following information when making this judgement:

- whether the contractual arrangement specifically defines the amounts and dates of the cash payments of the loan;
- the fair value of the collateral relative to the secured financial asset;
- the ability and willingness of the borrower to make contractual payments, notwithstanding a decline in the value of collateral;
- whether the borrower is a substantive operating entity or is a special-purpose entity;
- the Bank's risk of loss on the asset relative to a full-recourse loan;
- the extent to which the collateral represents all or a substantial portion of the borrower's assets; and
- whether the Bank will benefit from any upside from the underlying assets.

Reclassifications

The Bank reclassifies financial assets when and only when its business model for managing financial assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

The Bank fulfilled the requirements of reclassification during transition to IFRS 9 and such reclassification details are presented in transition disclosures (Note 28).

Policy applicable before 1 January 2018

The Bank classifies its financial assets into one of the following categories:

- loans and receivables;
- held to maturity;
- available-for-sale, and
- at FVPL, and within this category as:
    - held for trading; or
    - designated at FVPL.

The Bank classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or FVPL.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Subsequent to initial recognition, all non-trading financial liabilities, loans and receivables and held-to-maturity investment securities are measured at amortised cost using the effective interest method. Other financial assets, including derivatives shall be measured at their fair values, without any deduction for transaction costs it may incur on sale or other disposal.

7.7.3. Derecognition

The Bank derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received and (ii) any cumulative gain or loss that had been recognized in OCI is recognized in profit or loss.

The Bank derecognizes a financial liability when its contractual obligations are discharged or cancelled, or expire.

7.7.4. Modifications of financial assets

Policy applicable from 1 January 2018

If the terms of a financial asset are modified, then the Bank evaluates whether the cash flows of the modified asset are substantially different.

If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value plus any eligible transaction costs. Any fees received as part of the modification are accounted for as follows:

- fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and
- other fees are included in profit or loss as part of the gain or loss on derecognition.

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Bank plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place. This approach impacts the result of the quantitative evaluation and means that the de-recognition criteria are not usually met in such cases.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

If the modification of a financial asset measured at amortised cost or FVOCI does not result in de-recognition of the financial asset, then the Bank first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in profit or loss. For floating rate financial assets, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of modification. Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and amortised over the remaining term of the modified financial asset.

If such a modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income calculated using the effective interest method.

Policy applicable before 1 January 2018

If the terms of a financial asset were modified, then the Bank evaluated whether the cash flows of the modified assets were substantially different. If the cash flows were substantially different, then the contractual rights to cash flows from the original financial asset were deemed to have expired. In this case, the original financial asset was de-recognised and a new financial asset was recognised at fair value.

If the terms of a financial asset were modified because of financial difficulties of the borrower and the asset was not de-recognised, then impairment of the asset was measured using the pre-modification interest rate.

7.7.5. Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank currently has a legally enforceable right to set off the amounts and it intends either to settle them on a net basis or to realize the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions.

7.7.6. Fair value measurement

'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 in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When one is available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as 'active' if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an on-going basis.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

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

If an asset or a liability measured at fair value has a bid price and an ask price, then the Bank measures assets and long positions at a bid price and liabilities and short positions at an ask price.

The fair value of a financial liability with a demand feature (e.g. demand deposit) is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

The Bank recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

7.7.7. Impairment

<u>Policy applicable from 1 January 2018</u>

The Bank recognises loss allowances for expected credit losses on the following financial instruments that are not measured at FVPL:

- loans and advances to banks;
- loans and advances to customers;
- debt investment securities; and
- loan commitments issued.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- financial instruments that are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Bank considers a financial instrument to have low credit risk when its credit risk rating is from 1 up to and including 3.4 as per the Bank's internal credit rating system ('ICR').

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL are recognised are referred to as 'Stage 1 financial instruments'. A financial instrument that is not credit-impaired on initial recognition is classified in Stage-1 and has its credit continuously monitored by the Bank.

Life-time ECL are the ECL that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL are recognised but which are not credit-impaired are referred to as 'Stage 2 financial instruments'.

Financial instruments for which a lifetime ECL are recognised and which are credit-impaired are referred to as 'Stage 3 financial instruments'.

Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows; and
- Undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive.
- Financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised and ECL are measured as follows:

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets

At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI are credit-impaired (referred to as 'Stage 3 financial assets). A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment.

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 amortised 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.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in 'impairment losses on financial instruments' in the statement of profit or loss and OCI.

Policy applicable before 1 January 2018

At each reporting date, the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impairment losses on assets carried at amortised cost are measured as the differential between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognized in profit or loss and reflected in an allowance account against loans and advances. Interest on the impaired asset continues to be recognized through the unwinding of the discount.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for the groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through profit or loss.

If an available-for-sale investment security is determined to be impaired, the cumulative gain or loss previously recognized under the equity is recognized in the statement of profit or loss and other comprehensive income.

7.8. Cash and cash equivalents

Cash and cash equivalents include cash and balances with banks repayable on demand and money market placements with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments.

Cash and cash equivalents are carried at amortised cost in the statement of financial position (Note 11).

7.9. Derivatives

Derivatives are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. The fair values of derivative financial instruments that are quoted in active markets are determined from quoted market prices in active markets including recent market transactions. The fair values of financial derivatives that are not quoted in active markets are determined by using valuation techniques, including discounted cash flow models. Where valuation techniques (for instance, models) are used to determine fair values, they are validated and periodically reviewed. Fair values of derivatives are carried as assets when positive and as liabilities when negative. The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e. the fair value of the consideration given or received). Derivative financial instruments are classified as held for trading (Note 12).

7.10. Loans and advances

'Loans and advances' in the statement of financial position are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method (Notes 13 and 14).

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

7.11. Investment securities

Policy applicable after 1 January 2018

The 'investment securities' in the statement of financial position includes:

- debt investment securities measured at amortised cost; these are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method; and
- debt securities measured at FVOCI.

For debt securities measured at FVOCI, gains and losses are recognised in OCI, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:

- interest revenue using the effective interest method;
- ECL and reversals; and
- foreign exchange gains and losses.

When debt security measured at FVOCI is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss.

Policy applicable before 1 January 2018

Investment securities were initially measured at fair value plus, in the case of investment securities not at FVPL, incremental direct transaction costs, and subsequently accounted for depending on their classification as either held-to-maturity, FVPL or available-for-sale.

'Available-for-sale investments' are non-derivative investments that are designated as available-for-sale or are not classified as another category of financial assets. Available-for-sale investments comprise debt securities which are measured at fair value after initial recognition.

Interest income is recognised in profit or loss using the effective interest method. Foreign exchange gains or losses on available-for-sale debt security investments are recognised in profit or loss. Impairment losses are recognised in profit or loss.

Other fair value changes, other than impairment losses, are recognised in OCI and presented in the revaluation reserves within equity. When the investment is sold, the gain or loss accumulated in equity is reclassified to profit or loss.

7.12. Property and equipment

Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

If significant parts of an item of property or equipment have different useful lives, then they are accounted for as separate items (major components) of property and equipment.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Any gain loss on disposal of an item of property and equipment is recognised within other income in profit or loss.

Subsequent costs

Subsequent expenditure is capitalised only when it is probable that the future economic benefits of the expenditure will flow to the Bank. Ongoing repairs and maintenance are expensed as incurred.

Depreciation

Depreciation is calculated to write off the cost of items of property and equipment less their estimated residual values using the straight-line method over their estimated useful lives, and is recognised in profit or loss.

The estimated useful lives of significant items of property and equipment are as follows:

	Useful lives
Equipment	4-5 years
Motor vehicles	5 years
Furniture and fixture	10 years
Buildings (Shell and core)	50 years
Buildings (Interior fit-out)	15 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate (Note 16).

7.13. Investment property

Investment property is measured at cost, less accumulated depreciation and impairment losses.

Land and buildings that are held to earn rentals or for capital appreciation or both rather than for use in production, supply of goods or services, administrative purposes or sale in the ordinary course of business are classified as investment property.

As of reporting period, investment property comprises three properties held for lease. Depreciation is calculated using the straight-line method to write down the cost of such assets to their residual values (Note 17).

Estimated useful lives of investment property are as follows:

	Useful lives
Investment property (Shell and core)	50 years
Investment property (Interior fit-out)	15 years

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

7.14. Intangible assets

Intangible assets consist of computer software program and licenses. Intangible assets are measured at cost, less accumulated amortization and any accumulated impairment losses.

Subsequent expenditure on software assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Intangible assets are amortised on a straight-line basis in profit or loss over its estimated useful life, from the date on which it is available for use. The estimated useful life of intangible assets for the current and comparative periods is four to five years.

Amortisation methods, useful lives and residual values are reviewed at each reporting period and adjusted if appropriate (Note 18).

7.15. Impairment of non-financial assets

At each reporting date, the Bank reviews the carrying amounts of its non-financial assets to determine whether there is any indication of impairment. If any such indication exists, then the assets’ recoverable amount is estimated.

For impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that is largely independent of the cash inflows of other assets or cash-generating units (‘CGU’). A cash-generating unit is the smallest identifiable group of assets that generates cash inflows which are largely independent of the cash flows from other assets or group of assets.

The ‘recoverable amount’ of an asset or CGU is the greater of its value in use and its fair value less costs to sell. ‘value in use’ is based on the estimated future cash flows, discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

An impairment loss is recognised if the carrying amount of an asset or CGU exceeds its recoverable amount.

Impairment losses are recognised in profit or loss. An impairment loss recognized in prior periods for an asset is reversed if the subsequent increase in the asset’s recoverable amount is caused by a specific event since the last impairment loss was recognized. Such a reversal amount cannot be higher than the previously recognized impairment and is recognized as income in the financial statements.

7.16. Deposits

Deposits from banks are the Bank’s source of debt funding.

Deposits are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

7.17. Provisions, commitments and contingencies

Provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made.

Where the effect of the time value of money is material, the amount of provision shall be the present value of the expenditures expected to be required to settle the obligation. The discount rate reflects current market assessments of the time value of money and the risks specific to the liability. The discount rate shall be a pre-tax rate and shall not reflect risks for which future cash flow estimates have been adjusted.

Possible assets or obligations that arise from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Bank are not included in these financial statements and are treated as contingent assets or liabilities (Note 29).

7.18. Loan commitments

'Loan commitments' are firm commitments to provide credit under pre-specified terms and conditions.

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.

The Bank has issued no loan commitments that are measured at FVPL.

For loan commitments:

- from 1 January 2018: the Bank recognises a loss allowance;
- before 1 January 2018: the Bank recognises a provision in accordance with IAS 37 if the contract was considered to be onerous.

Liabilities arising from loan commitments are included in provisions.

7.19. Employee benefits

7.19.1. Defined contribution plans

Obligations for contributions to defined contribution plans are expensed as the related service is provided and recognised as personnel expense in profit or loss. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

The Bank pays contributions to Turkish State Social Security Plan on a mandatory basis for the local employees who do not opt for the Bank's pension plan. The Bank has no further payment obligations once the contributions have been paid.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

7.19.2. Pension plan

The Bank operates a pension plan implemented beginning from 1 October 2008, which includes first pillar as hybrid plan that is comprised of a defined benefit plan and defined contribution plan, second and third pillars as defined contribution plans. The expatriate employees are automatically enrolled in the first pillar whereas participation in the second pillar is at their will. The local employees can also opt for the Bank's pension plan voluntarily in lieu of Turkish State Social Security Plan. All employees are eligible to participate in the third pillar where participation in the first and/or second pillar is not a pre-requisite.

The requirements for the defined benefit part of the first pillar are attaining normal retirement age (which is 60 in accordance with the Pension Plan Policy), participating in the second pillar and transferring at least the amount equal to 90% of the first pillar account balance excluding the investment returns from the second pillar account to the first pillar account. If these requirements are met then the (participant) employee shall be entitled to the following benefits:

- Immediate pension equal to the amount of 1% of the annual average net basic salary of the employee during his/her eligible service period multiplied by number of years in service of the Bank;
- One twelfth of the immediate pension according to the previous paragraph that shall be paid to the employee every month.

The benefit provided will be as a lump sum but with respect to the rates that are linked to the length of the eligible service period for an employee not fulfilling the requirements described above. In case of death before normal retirement age, the benefit will be provided to employee or his/her legal beneficiary as a lump sum up equal to the balance of employee's account. Similarly in case of death of an employee already drawing pension, the full amount of the standing balance will be paid as a lump sum to employee's legal beneficiary.

According to the Pension Plan Policy of the Bank, an employee shall become entitled to a disability pension from the first pillar if the employee suffers a disability before attaining normal retirement age. If such a disability occurs the employee shall become entitled to disability pension in monthly amounts equals to 25% of the employee's last salary immediately before becoming disabled until the employee's normal retirement age. Nevertheless, the Bank shall continue its contribution for the first pillar for the disabled employee, until reaching normal retirement age on the basis of his/her last salary immediately before becoming disabled. After reaching the employee's normal retirement age the disability pension will cease and, upon the employee's choice it can be replaced by the pension benefits in accordance with the Pension Plan Policy. The time during which the disability pension has been paid will be included in the employee's service at the Bank when calculating the total pension benefits of the employee after reaching normal retirement age.

The pension plan is funded by contributions from employees and by the Bank depending on the type of the plan and with respect to the provisions of the Bank's Pension Plan Policy. Contribution rates to the pension plan are as follows:

Pension contributions of basic salary	Employer %	Employee %
First pillar	12	-
Second pillar	up to 7[(1)]	up to 7
Third pillar	-	up to 10

(1) The Bank contributes to the second pillar if and only if employee contributes but at the same matching rate up to 7%.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

For the defined benefit part of the hybrid plan and disability pension, the pension liability is calculated by using the 'projected unit credit method'. Under this method, the cost of providing pensions is charged to the statement of profit or loss and other comprehensive income so as to spread the regular cost over the service lives of employees. Actuarial valuations have been performed in accordance with the methods and estimations determined in International Accounting Standard for Employee Benefits ('IAS 19'). The pension liability is measured at the present value of the estimated future cash outflows using interest rates of government securities that have terms to maturity approximately the terms of the related liability. All actuarial gains and losses are recognized in income over the average remaining service lives of the employees (Note 21.1).

The Bank keeps; assets of the pension plan under its treasury investment portfolio and liabilities related to first, second and third pillars separately for each participant under employee benefits (Note 21.1). The Bank accrues interest on its liabilities to the pension plan which is calculated using the average return of the investment portfolio of the Bank's Treasury (Note 24).

7.19.3. Short term employee benefits

Short-term employee benefits are expensed as the related service is provided. A liability is recognised for the amount expected to be paid if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

The Bank provides annual leave pay provision for the employees under its employee Benefit System Policy. Full-time professional staff members are entitled to an annual leave of fifteen workdays per year with service of less than and including ten years and twenty workdays per year with service after ten years and more. New professional staff members will be eligible for annual leave after six months of service (Note 21.2).

7.19.4. Reserve for employee severance indemnity – Defined benefit plan

Provision for employee severance indemnity represents the present value of the estimated total provision of the future probable obligation of entities arising from the retirement of the employees calculated in accordance with the Turkish Labour Law. In accordance with Labour Law in Turkey, entities are required to make lump-sum termination indemnities to each employee whose employment is terminated due to retirement or for reasons other than resignation or misconduct and who has completed at least one year of service.

Provision is made for the present value of the defined benefit obligation calculated using the projected unit credit method. Actuarial gains/losses are recognized under equity.

These financial statements include provision for severance payment only for the service staff employed by the Bank according to Turkish Labour Law (Note 21.3).

7.20. Earnings per share

Since the Bank's shares are not traded in a public market and the Bank's financial statements are not filed or not in the process of filing with a securities commission or other regulatory organization for the purpose of issuing shares in a public market, the Bank is not required to disclose basic earnings per share ("EPS") information in accordance with IAS 33 Earnings Per Share.

NOTE 7 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

7.21. Segment reporting

An operating segment is a component of the Bank that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses relating to transactions with any of the other components of the Bank. All operating segments' operating results are regularly reviewed by the management to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available (Note 30).

7.22. Comparatives

The Bank has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognised directly in equity as of 1 January 2018. The transition impact on the accompanying financial statements regarding the first time adoption of IFRS 9 as of 1 January 2018 is presented in transition disclosures (Note 28).

NOTE 8 – STANDARDS ISSUED BUT NOT YET ADOPTED

8.1. IFRS 16 Leases

On 13 January 2016, IASB issued the new leasing standard which will replace IAS 17 Leases, IFRIC 4 Determining Whether an Arrangement Contains a Lease, Standard Interpretations Committee Interpretation ('SIC') 15 for Operating Leases – Incentives, and SIC 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease and consequently changes to IAS 40 Investment Properties. IFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, there is a single, on-balance sheet accounting model that is similar to current finance lease accounting. Lessor accounting remains similar to current practice. IFRS 16 is effective for annual periods beginning on or after 1 January 2019, with early adoption permitted provided that an entity also adopts IFRS 15 Revenue from Contracts with Customers. The Bank does not expect that application of IFRS 16 will have significant impact on its financial statements.

8.2. Other standards

The following amended standards are not expected to have a significant impact on the Bank's financial statements.

- Annual improvements to IFRS Standards 2015-2017 Cycle – various standards
- Long-term interests in Associates and Joint Ventures (Amendments to IAS 28)
- Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)
- IFRIC 23 Uncertainty over Income Tax Treatments
- Amendments to Reference to Conceptual Framework in IFRS Standards
- IFRS 17 Insurance Contracts

C. FINANCIAL RISK REVIEW AND FAIR VALUE

NOTE 9 – FINANCIAL RISK REVIEW

This section provides details of the Bank's exposure to risk and describes the methods used to manage those risks. The most important types of risk to which the Bank is exposed are credit risk, liquidity risk, market risk and operational risk.

9.1. Risk management framework

The Bank is committed to actively identify and manage all risks inherent in its activities in order to support its sustainable profitability objective and safeguard its capital base. The Bank pays particular attention to managing credit risk in the course of its core activities and treasury operations, liquidity risk, market risk in its treasury as well as compliance and operational risks in its organisation and activities.

By virtue of its mandate, the credit risk inherent in the Bank's ordinary operations is relatively high, due to the geographic concentration of its operational portfolio and the nature of the Bank's involvement in the projects it undertakes in conformity with article 2 of the Agreement. The application of sound banking principles in the Bank's credit process seeks to ensure that these significant credit risks are properly identified and managed while other risks resulting from its ordinary operations should be mitigated to the extent possible. Since the Bank's ordinary operations are inherently relatively risky, the management of treasury activities is conservative. A comprehensive risk management framework for treasury activities, particularly addressing credit and market risk are established.

The Bank's risk management policies are established for the identification and assessment of the risks, which the Bank may be exposed to and also to set appropriate risk limit controls for monitoring the same. The financial policies of the Bank approved by the Board of Directors establish the guiding principles for sound financial management and provide the framework within which the Bank pursues its business objectives.

Audit Committee is composed of three members from the different member countries, appointed by the Board of Governors. Audit Committee's purpose is to assist Board of Governors in fulfilling its oversight responsibilities.

The Board of Directors has established the Credit Committee which is responsible to guide the lending departments through the approval process from Concept Clearance to Final Review, in conformity with the Bank's Operations Cycle Policy. It considers all matters related to the lending operations of the Bank and expresses opinions with respect to the appropriateness of the due diligence and appraisal process.

The Board of Directors has established Asset and Liability Management Committee ('ALCO') which is responsible for setting strategic direction in market risk management and transfer pricing. ALCO establishes specific numerical limits, targets, and guidelines within which tactical and operational ALM decision-making must take place.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

9.2. Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and other banks, investment debt securities and derivatives. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure – e.g. individual obligor default risk, country and sector risk.

9.2.1. Management of credit risk

The Bank's primary exposures to credit risk arise through its loans and advances. The amount of credit exposure in this regard is represented by the carrying amounts of these assets on the statement of financial position. In view of the Bank's philosophy of prudent lending, the function of credit risk management has become a critical fulcrum of the Bank's long term vision and success. Credit analysis is conducted by using various information sources and applying qualitative and quantitative methodologies.

The Bank reviews lending operations and manages the main areas of credit risk which are inherent to the lending activities of the Bank in order to ensure that decisions are made in line with the Bank's strategy and that loan applications are prudently reviewed. Lending decisions are made to clients by following the guidelines laid down in various policies and through coordination with other business units to ensure that the loans are made in line with the Bank's overall risk appetite and strategy. All credit applications are evaluated by the Credit Committee which in case of approval elevates the same to the Board of Directors for final approval.

In addition to compliance function, the Bank's management also provides oversight and direction to the activities of risk management to ensure that the Bank's risk profile is in line with its strategy and operating environment, in a manner which ensures protection to the shareholders.

9.2.2. Exposure to credit risk

The Bank's exposure to credit risk as at 31 December 2018 and 31 December 2017 are as follows:

	31 December 2018	31 December 2017
Loans and advances to banks	314,243	341,017
Loans and advances to customers	133,425	129,798
Investment securities	22,716	14,068
Derivative financial instruments	800	663
Total	**471,184**	**485,546**

As of 31 December 2018, the Bank has no assets held for resale (31 December 2017: None).

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

9.2.3. Segment analysis of credit risk exposures

The following table breaks down the segment distribution of credit risk exposures.

	31 December 2018	31 December 2017
Treasury portfolio	**183,829**	**184,118**
Financial institutions-Bank placements	160,313	169,387
Investment securities	22,716	14,068
Derivative financial instruments	800	663
Loan portfolio	**287,355**	**301,428**
Financial institutions-Trade finance	96,800	91,621
Customers-Trade finance	68,955	54,015
Project finance	64,470	75,783
Financial institutions-SME support program	57,130	80,009
Total	**471,184**	**485,546**

9.2.4. Credit quality analysis

The Bank uses internal credit risk grading that reflects its assessment of the probability of default of individual counterparties. The Bank assigns its internal risk rating to all counterparties including borrowers and sovereigns in the Banking and Treasury portfolios and reflects the credit worthiness of counterparties. The Bank's internal risk rating depicts the credit worthiness of borrowers on a scale of 1 to 10 with a score of 1 denoting the lowest expectation of default while a score of 10 denotes non-performing. The table below shows the Bank's internal risk rating from 1 (lowest risk) to 10 (highest risk).

ETDB risk Rating category	Broader category	ETDB definition	ETDB risk rating
1	Standard	Excellent	1.00
2	Standard	Very strong	1.01 → 2.40
3	Standard	Strong	2.41 → 3.40
4	Standard	Good	3.41 → 4.40
5	Standard	Fair	4.41 → 5.40
6	Standard	Weak	5.41 → 6.50
7	Watch	Special attention	6.51 → 7.40
8	Sub-standard	Expected loss/Impaired	7.41 → 7.60
9	Doubtful	Expected loss/ Impaired	7.61 → 8.60
10	Non-performing	Expected loss/Impaired	8.61 → 10.00

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

The following table sets out information about the credit quality of financial assets measured at amortised cost and available-for-sale debts assets (2017). Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts. For loan commitments, the amounts in the table represent the amounts committed.

Explanation of the terms "Stage 1", "Stage 2" and "Stage 3" is included in Note 7.7.7.

	31 December 2018				31 December 2017
	Stage 1	**Stage 2**	**Stage 3**	**Total**	**Total**
Loans and advances to banks at amortised cost					
2: Very strong	-	-	-	-	57,616
3: Strong	171,948	-	-	171,948	28,548
4: Good	73,451	-	-	73,451	133,348
5: Fair	70,832	-	-	70,832	121,450
6: Weak	-	-	-	-	55
	316,231	-	-	316,231	341,017
Loss allowance	(1,988)	-	-	(1,988)	-
Carrying amount	**314,243**	**-**	**-**	**314,243**	**341,017**
Loans and advances to customers at amortised cost					
2: Very strong	57,898	-	-	57,898	80,859
4: Good	-	-	-	-	25,572
5: Fair	12,424	-	-	12,424	5,831
6: Weak	17,873	-	-	17,873	8,067
7: Special attention	-	-	-	-	9,469
9: Doubtful	-	14,039	-	14,039	-
10: Non-performing	-	-	33,699	33,699	-
	88,195	14,039	33,699	135,933	129,798
Loss allowance	(240)	(70)	(2,170)	(2,480)	-
Carrying amount	**87,955**	**13,969**	**31,529**	**133,453**	**129,798**
Debt investment securities at amortised cost (2017: available-for-sale)					
2: Very strong	3,646	-	-	3,646	4,032
3: Strong	19,172	-	-	19,172	10,036
	22,818	-	-	22,818	14,068
Loss allowance	(102)	-	-	(102)	-
Carrying amount	**22,716**	**-**	**-**	**22,716**	**14,068**
Loan commitments					
6: Weak	-	-	-	-	12,632
9: Doubtful	-	5,592	-	5,592	-
	-	5,592	-	5,592	12,632
Loss allowance	-	(28)	-	(28)	-
Carrying amount	**-**	**-**	**-**	**(28)**	**-**

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

The following table sets out information about the overdue status of loans and advances to banks and loans and advances to customers in Stages 1, 2 and 3.

	31 December 2018				31 December 2017
	Stage 1	**Stage 2**	**Stage 3**	**Total**	**Total**
Loans and advances to banks at amortised cost – gross carrying amount					
Current	312,639	-	-	312,639	341,017
Overdue ≤30 days	3,592	-	-	3,592	-
Overdue <60 days	-	-	-	-	-
Overdue ≤90 days	-	-	-	-	-
Overdue > 90 days	-	-	-	-	-
Total	**316,231**	**-**	**-**	**316,231**	**341,017**
Loans and advances to customers at amortised cost – gross carrying amount					
Current	88,195	-	-	88,195	128,870
Overdue ≤30 days	-	-	-	-	-
Overdue <60 days	-	-	-	-	928
Overdue ≤90 days	-	14,039	-	14,039	-
Overdue > 90 days	-	-	33,699	33,699	-
Total	**88,195**	**14,039**	**33,699**	**135,933**	**129,798**

9.2.5. Collateral held and other credit enhancements

Loans and advances to customers

The general creditworthiness of a customer tends to be the most relevant indicator of credit quality of a loan extended to it. However, collateral provides additional security and the Bank generally requests that corporate borrowers provide it. The Bank may take collateral in the form of a sovereign guarantee issued by a member state, bank guarantee, first charge over real estate, floating charges over all corporate assets and other liens and guarantees.

Because of the Bank's focus on corporate customers' creditworthiness, the Bank does not routinely update the valuation of collateral held against all loans to corporate customers. Valuation of collateral is updated when the loan is put on a watch list and the loan is monitored more closely. For credit-impaired loans, the Bank obtains appraisals of collateral because it provides input into determining the management credit risk actions.

In addition to the collaterals included in the tables below, the Bank holds other type of collateral and credit enhancements, such as second charges and floating charges for which specific values are not generally available.

Financial assets that are classified under Stage 2 and Stage 3 amount to EU 14,039 thousand and EU 33,699 thousand, respectively. Sovereign guarantees are held as collaterals against such project finance loans.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

The following table sets out the percentage of total exposure that is secured with different types of collaterals.

	31 December 2018		31 December 2017	
	Customers Trade finance	**Project finance**	**Customers Trade finance**	**Project finance**
Sovereign loans	74%	4%	53%	4%
Sovereign guarantee	-	78%	-	77%
Letter of credit from an FI	26%	8%	47%	8%
Charge on fixed assets	-	10%	-	11%
	100%	**100%**	**100%**	**100%**

9.2.6. Amounts arising from ECL

Significant increase in credit risk

The Bank monitors whether a financial instrument has experienced a significant increase in credit risk or not, on ad-hoc and regular basis as explained below.

The Bank executes supervision and monitoring process individually for all of its loan exposures, at least once in a year. The aim of this practice is to follow implementation and identify problems and changed circumstances as early as possible so that appropriate action may be applied on a timely basis to achieve the operation's objectives and to protect the Bank's investment. Apart from individual supervision and monitoring, Risk Management Department ('RMD') of the Bank is responsible for preparation of regular risk asset reviews for the Bank's loan portfolio at least annually. In normal course of business, the credit lines made available for treasury operations of the Bank are reviewed during the annual limit renewals of counterparties. Additionally, RMD also assesses whether the credit risk of a treasury asset has increased significantly or not. Finally, at each reporting date the Bank assesses whether the credit risk of any financial instrument has increased significantly since initial recognition or not.

Some of the quantitative and qualitative criteria that the Bank considers are as below:
- Change in Capital Adequacy Ratio
- Change in Minimum Capital Requirement
- Change in value of collateral
- Change in the value of guarantee
- Change in financial support from a parent company
- Changes to the contractual framework
- Expected change in loan documentation
- Change in credit spread
- Change in in regulatory environment
- Change in management
- Shift or obsoletion of the technology
- Gross Domestic Product Growth Rate
- Inflation
- Exchange Rate
- Interest rate
- Unemployment Rate

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

- External Rating
- Credit Default Swap Rate

There is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. 30 days past due presumption can be rebutted if there is reasonable and supportable information, that demonstrates that the credit risk has not increased significantly since initial recognition even though the contractual payments are more than 30 days past due.

By using the qualitative and quantitative factors given above together with the recent financial information of the asset, RMD offers to transfer a financial asset to Stage 2 or Stage 3 if the internal rating exceeds 6.50 and 7.40, respectively.

Inputs, assumptions and techniques used for estimating impairment

The Expected Credit Losses are the product of the probability of default ('PD'), the exposure at default ('EAD'), and loss given default ('LGD'), defined as follows:

- The PD represents the likelihood of a borrower defaulting on its financial obligation, either over the next 12 months, or over the remaining lifetime of the obligation.
- EAD is based on the amounts the Bank expects to be owed at the time of default, over the next 12 months or over the remaining lifetime. For example, for a loan commitment, the Bank includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur.
- LGD represents the Bank's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type and seniority of claim and availability of collateral and other credit support. LGD is expressed as a percentage loss per unit of exposure at the time of default.

Usual practices for deriving PD values for credit exposures often focus on mapping mechanisms to bank-wide master scales or external ratings. However, the Bank's credit exposure is with an overall good quality of borrowers and composed of high-volume-low-number transactions.

As the Bank does not have sufficient default experience over years, zero or close to zero PD estimates would not reflect the Bank's prudent risk management practice. In order to overcome this issue, the Bank benefitted from the results of the low-default portfolio research which is widely recognized as the industry best practice. The Bank estimated the PDs by upper confidence bounds while guaranteeing at the same time a PD ordering that respects the differences in credit quality by internal credit ratings.

Taking into account the Bank's preferential treatment among member states and lower risk of lost in case of a default of a financial institution compared to a customer; the Bank calibrated different LGD estimates for Sovereigns, financial institutions and other clients. Based on the type and coverage of collateral, LGD is adjusted in order to reflect probable loss in case of default.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

Definition of default

The Bank may consider a financial asset to be in default when:

- the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realizing security (if any is held); or
- the borrower is past due more than 90 days on any material credit obligation to the Bank.

In assessing whether a borrower is in default, the Bank considers indicators that are:

- qualitative – e.g. breaches of covenant;
- quantitative – e.g. overdue status and non-payment on another obligation of the same issuer to the Bank; and
- based on data developed internally and obtained from external sources.

There is a rebuttable presumption that default occurs when contractual payments are more than 90 days past due. 90 days past due presumption can be rebutted if there is reasonable and supportable information available that demonstrates that even financial asset is more than 90 days past due this does not represent a default.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

Loss Allowance

The following tables show reconciliations from the opening to the closing balance of the loss allowance by class of financial instrument.

Loans and advances to banks at amortised cost:

	31 December 2018			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Balance at 31 December 2017	-	-	-	-
Impact of adopting IFRS 9 at 1 January 2018	2,038	-	-	2,038
Balance at 1 January	2,038	-	-	2,038
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Net remasurement of loss allowance	(90)	-	-	(90)
New financial assets originated	1,537	-	-	1,537
Financial assets that have been derecognised	(1,484)	-	-	(1,484)
Foreign exchange movements	(13)	-	-	(13)
Balance at the end of the period	**1,988**	**-**	**-**	**1,988**

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

Loans and advances to customers at amortised cost:

	31 December 2018			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Balance at 31 December 2017	-	-	-	-
Impact of adopting IFRS 9 at 1 January 2018	472	-	-	472
Balance at 1 January	472	-	-	472
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	(5)	5	-	-
Transfer to Stage 3	(16)	-	16	-
Net remasurement of loss allowance	(308)	94	2,154	1,940
New financial assets originated	105	-	-	105
Financial assets that have been derecognised	(13)	-	-	(13)
Foreign exchange movements	4	-	-	4
Balance at the end of the period	**239**	**99**	**2,170**	**2,508**

Investment securities at amortised cost:

	31 December 2018			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Balance at 31 December 2017	-	-	-	-
Impact of adopting IFRS 9 at 1 January 2018	66	-	-	66
Balance at 1 January 2018	66	-	-	66
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Net remasurement of loss allowance	10	-	-	10
New financial assets originated	25	-	-	25
Financial assets that have been derecognised	-	-	-	-
Foreign exchange movements	1	-	-	1
Balance at the end of the period	102	-	-	102

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

9.2.7. Concentration of credit risks

The Bank monitors concentration of credit risk by sector and by geographic location. An analysis of concentrations of credit risk from loans and loan commitments and investment securities is shown below.

Concentration by sector

	31 December 2018		31 December 2017	
	Outstanding	**Undrawn commitments**	**Outstanding**	**Undrawn commitments**
Financial sector	**334,115**	**-**	**352,070**	**-**
Bank placements	160,313	-	169,387	-
Financial institutions-SME SP	57,130	-	80,009	-
Financial institutions-Trade finance	96,800	-	91,621	-
Investment securities	19,072	-	10,390	-
Derivative financial instruments	800	-	663	-
Energy	**79,027**	**-**	**59,318**	**-**
Customers-Trade finance	51,262	-	28,444	-
Project finance	27,765	-	30,874	-
Water, Sanitation, Flood Protection and other Urban Infrastructure Services	**22,831**	**5,592**	**23,938**	**-**
Project finance	22,831	5,592	23,938	-
Industry and Trade	**17,693**	**-**	**25,571**	**-**
Customers-Trade finance	17,693	-	25,571	-
Project finance	-	-	-	-
Agriculture, natural resources, and rural development	**7,256**	**-**	**9,469**	**-**
Project finance	7,256	-	9,469	-
Public sector management	**6,043**	**-**	**6,956**	**-**
Investment securities (1)	3,644	-	3,678	-
Project finance	2,399	-	3,278	-
Transportation	**4,219**	**-**	**8,224**	**-**
Project finance	4,219	-	8,224	-
Health and Social Protection	**-**	**-**	**-**	**12,632**
Project finance	-	-	-	12,632
Total	**471,184**	**5,592**	**485,546**	**12,632**

(1) Investment securities classified under Public sector management are Government debt securities issued by Islamic Republic of Pakistan.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

Concentration by geographic location

	31 December 2018		31 December 2017	
	Outstanding	Undrawn commitments	Outstanding	Undrawn commitments
Turkey	**298,277**	**-**	**243,574**	**12,632**
Treasury portfolio	168,885	-	119,768	-
Loan portfolio	129,392	-	123,806	12,632
Iran	**73,625**	**5,592**	**132,144**	**-**
Treasury portfolio	24	-	49,452	-
Loan portfolio	73,601	5,592	82,692	-
Pakistan	**88,059**	**-**	**98,285**	**-**
Treasury portfolio	3,697	-	4,058	-
Loan portfolio	84,362	-	94,227	-
Azerbaijan	**-**	**-**	**703**	**-**
Treasury portfolio	-	-	-	-
Loan portfolio	-	-	703	-
Other	**11,223**	**-**	**10,840**	**-**
Treasury portfolio	11,223	-	10,840	-
Loan portfolio	-	-	-	-
Total	**471,184**	**5,592**	**485,546**	**12,632**
Treasury portfolio	183,829	-	184,118	-
Loan portfolio	287,355	5,592	301,428	12,632

9.3. Liquidity risk

Liquidity risk is defined as the risk that the Bank will encounter difficulty in meeting its obligations associated with financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk arises from mismatches in the timing and amounts of cash flows, which is inherent to the Bank's operations and investments.

9.3.1. Management of liquidity risk

Liquidity risk is managed by Treasury Department under the guidelines provided by ALCO which are in line with the policies approved by the Board of Directors. According to the ALCO approved procedures at all times, the Bank has at its disposal a liquidity pool large enough to finance new assets or refinance existing assets. Under stressed conditions, liquidity risk is managed within the contingency liquidity plan framework approved by ALCO.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when they are due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation. The key elements of the Bank's liquidity strategy are as follows.

- Carrying a portfolio of highly liquid assets, diversified by currency and maturity.
- Minimizing maturity mismatches.
- Stress testing of the Bank's liquidity position against various exposures and country-specific events.

Treasury Department receives information from other business units regarding the liquidity profile of their financial assets and details of other projected cash flows arising from projected future business. Treasury Department then maintains a portfolio of short-term liquid assets, largely made up of money market placements, to ensure that sufficient liquidity is maintained.

Monthly liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. The scenarios are developed taking into account payment defaults on assets.

9.3.2. Exposure to liquidity risk

The key measure used by the Bank for managing liquidity risk is the ratio of liquid assets to net cash requirements (including projected loan disbursements). Ratios are maintained at a minimum of;

- 100% for the next 1 month,
- 100% for the next 3 months, and
- 75% for the next 12 months.

Details of the reported ratio of liquid assets to net cash requirements for the next 12 months at the reporting date and during the reporting period were as follows.

	31 December 2018
At period end	396%
Average for the period	272%
Maximum for the period	640%
Minimum for the period	151%

Additionally, the Bank's liquidity is maintained at a minimum of 12% of the total equity plus long term borrowing with remaining time to maturity greater than six months.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

9.3.3. Maturity analysis for financial liabilities and financial assets

The following table sets out the remaining contractual maturities of the Bank's financial liabilities and financial assets.

	31 December 2018						
	Carrying Amount	**Gross Nominal inflow/ (outflow)**	**Less Than 1 month**	**1 to 3 months**	**3 to 12 months**	**1 to 5 years**	**More than 5 years**
Financial liability by type							
Non-derivative liabilities							
Deposits from banks	92,692	(93,136)	-	(46,501)	(46,635)	-	-
Undrawn loan commitments	-	(5,592)	(5,592)	-	-	-	-
- Banks	-	-	-	-	-	-	-
- Customers	-	(5,592)	(5,592)	-	-	-	-
Total	**92,692**	**(98,728)**	**(5,592)**	**(46,501)**	**(46,635)**	**-**	**-**
Derivative liabilities							
Trading FX derivatives	444						
- Outflow		(22,220)	(9,442)	(12,778)	-	-	-
- Inflow		21,805	9,283	12,522	-	-	-
Total	**444**	**(415)**	**(159)**	**(256)**	**-**	**-**	**-**
Financial asset by type							
Non-derivative assets							
Loans and advances to banks	314,243	321,753	56,456	127,175	108,052	30,070	-
Loans and advances to customers	133,425	143,834	913	34,565	45,499	47,642	15,215
Investment securities	22,716	26,113	-	14	10,636	15,463	-
Total	**470,384**	**491,700**	**57,369**	**161,754**	**164,187**	**93,175**	**15,215**
Derivative assets							
Trading FX derivatives	800						
- Outflow		(74,949)	(23,150)	(51,799)	-	-	-
- Inflow		75,910	23,631	52,279	-	-	-
Total	**800**	**961**	**481**	**480**	**-**	**-**	**-**

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

	31 December 2017						
	Carrying Amount	**Gross Nominal inflow/ (outflow)**	**Less Than 1 month**	**1 to 3 months**	**3 to 12 months**	**1 to 5 years**	**More than 5 years**
Financial liability by type							
Non-derivative liabilities							
Deposits from banks	117,228	(117,595)	(17,179)	(63,611)	(36,805)	-	-
Undrawn loan commitments	-	(12,632)	(12,632)	-	-	-	-
- Banks	-	-	-	-	-	-	-
- Customers	-	(12,632)	(12,632)	-	-	-	-
Total	**117,228**	**(130,227)**	**(29,811)**	**(63,611)**	**(36,805)**	**-**	**-**
Derivative liabilities							
Trading FX derivatives	732						
- Outflow		(53,124)	(10,203)	(42,921)	-	-	-
- Inflow		52,539	9,981	42,558	-	-	-
Total	**732**	**(585)**	**(222)**	**(363)**	**-**	**-**	**-**
Financial asset by type							
Non-derivative assets							
Loans and advances to banks	341,017	351,738	67,774	135,909	63,663	76,623	7,769
Loans and advances to customers	129,798	141,401	2,770	5,716	19,434	96,418	17,063
Investment securities	14,068	17,206	-	-	804	16,402	-
Total	**484,883**	**510,345**	**70,544**	**141,625**	**83,901**	**189,443**	**24,832**
Derivative assets							
Trading FX derivatives	663						
- Outflow		(41,336)	(21,888)	(19,448)	-	-	-
- Inflow		42,112	22,287	19,825	-	-	-
Total	**663**	**776**	**399**	**377**	**-**	**-**	**-**

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

The amounts in the above table have been compiled as follows.

Type of financial instrument	Basis on which amounts are compiled
Non-derivative financial liabilities and Financial assets	Undiscounted cash flows, which include estimated interest payments
Undrawn loan commitments	Earliest possible contractual maturity.
Derivative financial liabilities and Derivative financial assets	Contractual undiscounted cash flows. The amounts shown are the gross nominal inflows and outflows for derivatives that have simultaneous gross settlement (e.g. forward exchange contracts and currency swaps).

The following table sets out the carrying amounts of non-derivative financial assets and financial liabilities expected to be recovered or settled less than 12 months after the reporting date.

	31 December 2018	31 December 2017
Financial assets		
Loans and advances to banks	284,658	263,340
Loans and advances to customers	75,918	23,219
Investment securities	9,624	-
Financial liabilities		
Deposits from banks	92,692	117,228

The following table sets out the carrying amounts of non-derivative financial assets and financial liabilities expected to be recovered or settled more than 12 months after the reporting date.

	31 December 2018	31 December 2017
Financial assets		
Loans and advances to banks	29,585	77,677
Loans and advances to customers	57,507	106,579
Investment securities	13,092	14,068
Financial liabilities		
Deposits from banks	-	-

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

9.3.4. Liquidity reserves

The following table sets out the components of the Bank's liquidity reserves.

	31 December 2018		31 December 2017	
	Carrying amount	Fair value	Carrying amount	Fair value
Demand deposits	709	709	1,556	1,556
Money market placements	159,604	160,613	167,831	167,831
Investment securities	22,716	21,331	14,068	14,068
Total	**183,029**	**182,653**	**183,455**	**183,455**

As of 31 December 2018, the Bank does not have any financial asset recognised in the statement of financial position that had been pledged as collateral for liabilities (31 December 2017: None).

9.4. Market risk

Market risk is defined as the risk that changes in market prices will affect the Bank's income or the value of its holdings of financial instruments. The objective of the Bank's market risk management is to manage and control market risk exposures within acceptable parameters to ensure the Bank's sustainability while optimising the return on risk. Since the Bank's ordinary operations are inherently relatively risky, a conservative and comprehensive risk management framework addressing market risk has been established.

9.4.1. Currency risk

Currency risk is defined as the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Bank's risk management policies do not allow holding of significant foreign currency positions.

The main measurement currencies of the Bank's operations are SDR basket currencies namely; Euro, US Dollar, Chinese Yuan, British Pound and Japanese Yen. As the functional currency of the Bank is SDR, the financial statements are affected by currency exchange rate fluctuations against SDR.

Considering the appetite of clients in the member countries only for US Dollar and Euro in loan and treasury operations, the Bank mostly invests in these two currencies. The currency swap and forward transactions are mostly held for yield enhancement, to provide liquidity in US Dollar and Euro against Chinese Yuan, British Pound and Japanese Yen.

By policies in place, the Bank monitors the current status of its assets and liabilities in contrast to SDR in order to ensure that it takes currency risk within the approved limits. For each currency, ALCO set a limit of ±1.0% of the equity for currency open positions. Treasury department is duly responsible to constantly monitor, to regularize any breach of the aforesaid limit and to report to ALCO on a monthly basis.

In order to monitor the foreign currency exposures, net foreign currency position figures are adjusted by the currency neutral position amounts for Euro, US Dollar, Chinese Yuan, British Pound and Japanese Yen which is calculated based on their respective weights in SDR basket as of reporting date.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

As at 31 December 2018 and 31 December 2017 the foreign currency position of the Bank is as follows:

	31 December 2018					
	US Dollar	**Euro**	**Other**	**Total foreign currency**	**SDR ('EU')**	**Total**
Assets						
Loans and advances to banks	84,395	229,832	16	314,243	-	314,243
Loans and advances to customers	70,262	63,163	-	133,425	-	133,425
Investment securities	21,047	1,669	-	22,716	-	22,716
Derivative financial instruments	-	-	-	-	800	800
Property and equipment	-	-	-	-	7,658	7,658
Investment property	-	-	-	-	1,743	1,743
Intangible assets	-	-	-	-	70	70
Other assets	110	956	38	1,104	-	1,104
Total assets	**175,814**	**295,620**	**54**	**471,488**	**10,271**	**481,759**
Liabilities and Equity						
Deposits from banks	-	92,692	-	92,692	-	92,692
Derivative financial instruments	-	-	-	-	444	444
Employee benefits	3,296	-	14	3,310	-	3,310
Other liabilities	226	561	19	806	-	806
Equity	-	-	(3)	(3)	384,510	384,507
Total liabilities and Equity	**3,522**	**93,253**	**30**	**96,805**	**384,954**	**481,759**
Net balance sheet position	**172,292**	**202,367**	**24**	**374,683**	**(374,683)**	**-**
Off-balance sheet derivative instruments net notional position(1)	(13,979)	(83,190)	97,715	546	-	546
Net foreign currency position	**158,313**	**119,177**	**97,739**	**375,229**	**(374,683)**	**546**
Currency neutral position	**(156,977)**	**(119,362)**	**(98,344)**	**(374,683)**	**374,683**	**-**
FX exposure in notional Ccy (2)	**1,336**	**(185)**	**(605)**	**546**	**-**	**546**

(1) Off-balance sheet derivative instruments net notional position in Chinese Yuan, Pound Sterling and Japanese Yen are EU 39,786 thousand, EU 29,108 thousand and EU 28,821 thousand, respectively.

(2) The total foreign currency exposure in Pound Sterling, Chinese Yuan, Japanese Yen, Iranian Rial, Turkish Lira and Pakistani Rupee are EU (292) thousand, EU (221) thousand, EU (113) thousand, EU 10 thousand, EU 6 thousand and EU 5 thousand, respectively.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

	31 December 2017					
	US Dollar	**Euro**	**Other**	**Total foreign currency**	**SDR ("EU")**	**Total**
Assets						
Loans and advances to banks	116,915	224,085	17	341,017	-	341,017
Loans and advances to customers	53,843	75,955	-	129,798	-	129,798
Investment securities	12,314	1,754	-	14,068	-	14,068
Derivative financial instruments	-	-	-	-	663	663
Property and equipment	-	-	-	-	7,735	7,735
Investment property	-	-	-	-	1,762	1,762
Intangible assets	-	-	-	-	115	115
Other assets	19	273	61	353	-	353
Total assets	**183,091**	**302,067**	**78**	**485,236**	**10,275**	**495,511**
Liabilities and Equity						
Deposits from banks	-	117,228	-	117,228	-	117,228
Derivative financial instruments	-	-	-	-	732	732
Employee benefits	3,060	-	13	3,073	-	3,073
Other liabilities	384	718	30	1,132	-	1,132
Equity	15	34	-	49	373,297	373,346
Total liabilities and Equity	**3,459**	**117,980**	**43**	**121,482**	**374,029**	**495,511**
Net balance sheet position	**179,632**	**184,087**	**35**	**363,754**	**(363,754)**	**-**
Off-balance sheet derivative instruments net notional position(1)	(30,089)	(64,371)	94,651	191	-	191
Net foreign currency position	**149,543**	**119,716**	**94,686**	**363,945**	**(363,754)**	**191**
Currency neutral position	**(148,794)**	**(118,465)**	**(96,495)**	**(363,754)**	**363,754**	**-**
FX exposure in notional Ccy (2)	**749**	**1,251**	**(1,809)**	**191**	**-**	**191**

(1) Off-balance sheet derivative instruments net notional position in Chinese Yuan, Pound Sterling and Japanese Yen are EU 39,788 thousand, EU 28,471 thousand and EU 26,392 thousand, respectively.

(2) The total foreign currency exposure in Pound Sterling, Japanese Yen, Chinese Yuan, Turkish Lira, Iranian Rial and Pakistani Rupee are EU (1,186) thousand, EU (531) thousand, EU (122) thousand, EU 12 thousand, EU 12 thousand and EU 6 thousand, respectively.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

Sensitivity analysis

The basis for the sensitivity analysis to measure foreign exchange risk is an aggregate corporate-level currency exposure. The aggregate foreign exchange exposure is composed of all assets and liabilities denominated in foreign currencies.

The currency value of the SDR is determined by summing the values in US Dollar, with market exchange rates of the US Dollar, Euro, Japanese Yen, Pound Sterling and the Chinese Yuan. Therefore, any change in the US Dollar parity of the other currencies effect SDR parities of all the basket currencies. In this respect, foreign currency sensitivity is calculated based on appreciation/depreciation of the US Dollar against other SDR basket currencies with 10 percent. This would have increased/ (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant.

	31 December 2018		31 December 2017	
	Appreciation	**Depreciation**	**Appreciation**	**Depreciation**
US Dollar	8,829	(9,610)	8,489	(9,203)
Euro	(4,668)	5,334	(4,745)	5,073
Chinese Yuan	(1,756)	1,587	(1,595)	1,633
Pound	(1,171)	1,271	(1,120)	1,217
Japanese Yen	(1,020)	1,406	(953)	1,224
Total	**214**	**(12)**	**76**	**(56)**

9.4.2. Interest rate risk

Interest rate risk is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates. Bank is exposed to the interest rate risk to the extent that interest-earning assets and interest-bearing liabilities mature or re-price at different time periods or in different amounts. Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved duration limits for the liquid portfolio. The goal of interest rate risk management is to reduce effect of interest rate change on its Net Interest Income ('NII').

ALCO is the monitoring body for compliance with these limits and is assisted by Treasury Department in its periodical monitoring activities which is reviewed and discussed by ALCO during its monthly meetings and, if necessary, emergency ALCO Meetings which could be held at very short notice.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

The following is a summary of the Bank's interest rate gap position. The interest rate repricing gap table analyses the full-term structure of interest rate mismatches within the Bank's balance sheet based on either (i) the next repricing date or the maturity date if floating rate or (ii) the maturity date if fixed rate.

	31 December 2018					
	Up to 1 month	**1 to 3 months**	**3 to 12 months**	**Over 1 year**	**Non-interest bearing**	**Carrying amount**
Assets						
Loans and advances to banks	62,460	128,909	122,874	-	-	314,243
Loans and advances to customers	6,928	62,282	64,215	-	-	133,425
Investment securities	-	12	9,714	12,990	-	22,716
Derivative financial instruments	-	-	-	-	800	800
Property and equipment	-	-	-	-	7,658	7,658
Investment property	-	-	-	-	1,743	1,743
Intangible assets	-	-	-	-	70	70
Other assets	-	-	-	-	1,104	1,104
Total assets	**69,388**	**191,203**	**196,803**	**12,990**	**11,375**	**481,759**
Liabilities						
Deposits from banks	-	46,459	46,233	-	-	92,692
Derivative financial instruments	-	-	-	-	444	444
Employee benefits	-	3,071	-	-	239	3,310
Other liabilities	-	-	-	-	806	806
Total liabilities	**-**	**49,530**	**46,233**	**-**	**1,489**	**97,252**
Net repricing gap	**69,388**	**141,673**	**150,570**	**12,990**	**9,886**	**384,507**

	31 December 2017					
	Up to 1 month	**1 to 3 months**	**3 to 12 months**	**Over 1 year**	**Non-interest bearing**	**Carrying amount**
Assets						
Loans and advances to banks	79,572	156,131	105,314	-	-	341,017
Loans and advances to customers	13,898	70,990	44,910	-	-	129,798
Investment securities	-	11	117	13,940	-	14,068
Derivative financial instruments	-	-	-	-	663	663
Property and equipment	-	-	-	-	7,735	7,735
Investment property	-	-	-	-	1,762	1,762
Intangible assets	-	-	-	-	115	115
Other assets	-	-	-	-	353	353
Total assets	**93,470**	**227,132**	**150,341**	**13,940**	**10,628**	**495,511**
Liabilities						
Deposits from banks	17,174	63,562	36,492	-	-	117,228
Derivative financial instruments	-	-	-	-	732	732
Employee benefits	-	2,860	-	-	213	3,073
Other liabilities	-	-	-	-	1,132	1,132
Total liabilities	**17,174**	**66,422**	**36,492**	**-**	**2,077**	**122,165**
Net repricing gap	**76,296**	**160,710**	**113,849**	**13,940**	**8,551**	**373,346**

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

Sensitivity analysis

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and financial liabilities to various interest rate scenarios. For the assessment of the interest rate sensitivity of the Bank ±0.25% shift in the market interest rates were applied to the statement of financial position items which are subject to calculation.

As of reporting date it is assumed that the interest rates are shifted. Hence, the calculated figures do not reflect the effect on current profit or loss and equity if the interest rates during the period would have been different. The table below analyses the effects of ±0.25% shift in interest rates of US Dollar and Euro on profit or loss and equity at the reporting date.

		31 December 2018		31 December 2017	
	Applied shock	**Profit or loss**	**Equity (1)**	**Profit or loss**	**Equity (1)**
US Dollar	- 0.25%	(88)	(88)	(107)	(39)
US Dollar	+ 0.25%	88	88	107	39
Euro	- 0.25%	10	10	(2)	4
Euro	+ 0.25%	(10)	(10)	2	(4)
Total (for negative shocks)		**(78)**	**(78)**	**(109)**	**(35)**
Total (for positive shocks)		**78**	**78**	**109**	**35**

(1) Includes the profit or loss effect.

9.5. Compliance and Operational risk

'Compliance Risk' is defined as the risk of legal or regulatory sanctions, material financial loss or loss to reputation that the Bank may suffer as a result of its failure to comply with its own regulations, policies and procedures and relevant international standards of best/good practice. 'Operational Risk' is specifically defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

The Management Committee of the Bank is responsible for the effective management of the Bank's compliance risk in care of the 'Policy and Compliance Department' and operational risk in care of Operational Risk Committee under comprehensive risk management framework. The 'Policy and Compliance Department' assists the Management Committee in effectively supervising and managing the compliance risk that the Bank can face. To this end, 'Policy and Compliance Department' identifies, assesses, and advises on; reviews and reports accordingly on the Bank's potential compliance risks.

Appropriate measures are taken by the Bank to achieve a high level of operational risk awareness and to enhance the operational risk management. The Bank adopts market best practices and methods to manage and coordinate its operational risks. Key processes for the management of operational risk include, amongst others; establishing the necessary internal controls such as the 'four eyes principle' and proper segregation of duties within Bank departments; the purchase of corporate and property insurance policies to confront potential losses which may occur as a result of various events and natural disasters; and the approval process of new products to identify and assess the operational risk related to each new product, activity, process and system.

NOTE 9 – FINANCIAL RISK REVIEW (Continued)

9.6. Capital management

As a multilateral financial institution, the Bank is not subject to regulatory capital requirements. However, the Bank preserves an actively managed capital to prudently cover risks in its activities. In this respect, the Bank follows sound standards as benchmarks for risk management and capital framework.

The principal sources of capital increase are through payments of the subscribed capital by the shareholders and the retention of the undistributed element of the profit. Pursuant to Article 4 of the Agreement, the capital stock of the Bank can be increased by the vote of the Board of Governors. In accordance with Article 27 of the Agreement, the Board of Governors determine annually what part of the net income of the Bank from ordinary capital operations shall be allocated to reserves, provided that no part of the net income of the Bank shall be distributed to members by way of profit until the General Reserves of the Bank shall have attained the level of 25% of the subscribed capital. In substance, the primary objective of the Bank's capital management is to ensure adequate capital is available to expand the Bank's operations.

NOTE 10 – FAIR VALUES OF FINANCIAL INSTRUMENTS

Valuation models

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements.

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

Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which observable market prices exist, and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and foreign currency exchange rates.

NOTE 10 – FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

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

The Bank uses widely recognised valuation models to determine the fair value of common and simple financial instruments, such as currency swaps, that use only observable market data and require little management judgement and estimation. Observable prices or model inputs are usually available in the market for listed debt securities and simple derivatives. The availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determining fair values. The availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Bank uses proprietary valuation models, which are usually developed from recognised valuation models. Some or all of the significant inputs into these models may not be observable in the market, and may be derived from market prices or rates or estimated based assumptions. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in determination of fair value. Management judgement and estimation are usually required for the selection of appropriate valuation model to be used, determination of expected future cash flows on the financial instrument being valued, determination of the probability of the counterparty default and prepayments, determination of expected volatilities and correlations and selection of appropriate discount rates.

The following methods and assumptions were used to estimate the fair value of the financial instruments for which it is practicable to estimate fair value:

- The fair values of demand deposits denominated in other than presentation currency, which are translated at period-end exchange rates, are considered to approximate carrying values.
- The fair value of derivative financial instruments is estimated as the present value of future cash flows, using benchmark interest rates and yield curves.
- The fair values of loans and advances are determined by discounting contractual cash flows with the sum of original spread and the respective base interest rate as of the reporting date.
- The fair value of investment securities is estimated using the bid prices quoted as of the reporting date.
- The fair values of deposits from banks are determined by discounting contractual cash flows with the sum of original spread and the respective benchmark interest rate as of the reporting date.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 10 – FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

As of 31 December 2018 and 31 December 2017, the carrying amounts and fair values of financial instruments, by the level in the fair value hierarchy into which each fair value measurement is categorised, are as follows:

	31 December 2018				
	Level 1	**Level 2**	**Level 3**	**Total fair values**	**Total carrying amount**
Financial assets not measured at fair value					
Loans and advances to banks	-	-	315,266	315,266	314,243
Loans and advances to customers	-	-	133,776	133,776	133,425
Investment securities	21,331	-	-	21,331	22,716
Financial assets measured at fair value					
Derivative financial instruments	-	800	-	800	800
Total financial assets	**21,331**	**800**	**449,042**	**471,173**	**471,184**
Financial liabilities not measured at fair value					
Deposits from banks	-	-	92,678	92,678	92,692
Financial liabilities measured at fair value					
Derivative financial instruments	-	444	-	444	444
Total financial liabilities	**-**	**444**	**92,678**	**93,122**	**93,136**

	31 December 2017				
	Level 1	**Level 2**	**Level 3**	**Total fair values**	**Total carrying amount**
Financial assets not measured at fair value					
Loans and advances to banks	-	-	340,997	340,997	341,017
Loans and advances to customers	-	-	129,846	129,846	129,798
Financial assets measured at fair value					
Investment securities	14,068	-	-	14,068	14,068
Derivative financial instruments	-	663	-	663	663
Total financial assets	**14,068**	**663**	**470,843**	**485,574**	**485,546**
Financial liabilities not measured at fair value					
Deposits from banks	-	-	117,228	117,228	117,228
Financial liabilities measured at fair value					
Derivative financial instruments	-	732	-	732	732
Total financial liabilities	**-**	**732**	**117,228**	**117,960**	**117,960**

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

D. ASSETS

NOTE 11 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash and balances with banks repayable on demand and money market placements with original maturities of less than three months. Cash and cash equivalents as of 31 December 2018 and 2017, included in the accompanying statement of cash flows are as follows:

	31 December 2018	31 December 2017
Loans and advances to banks-demand	709	1,556
Loans and advances to banks-time (with original maturity less than three months)	113,450	109,156
Total	**114,159**	**110,712**

NOTE 12 – DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments mainly consist of foreign currency swaps and foreign currency forward contracts.

"Foreign currency forwards" represent commitments to purchase or sell currency, including undelivered spot transactions.

"Foreign currency swaps" are commitments to exchange one set of cash flows for another. Swaps result in an economical exchange of currencies or interest rates. Currency swaps involve the exchange of the principal as well. The Bank risks are represented by the potential cost of replacing the swap contracts if counterparties fail to perform their obligation. This risk is monitored on an on-going basis with reference to the current fair value and the liquidity of the market. To control the level of risk taken, the Bank assesses counterparties using the same techniques as for its lending activities.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognized on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments, and therefore, do not indicate the Bank's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in foreign exchange rates and interest rates relative to their terms.

	31 December 2018		31 December 2017	
	Assets	Liabilities	Assets	Liabilities
Derivatives held for trading:				
Currency swaps	800	(444)	663	(732)
Total	**800**	**(444)**	**663**	**(732)**

The notional amounts of derivative transactions are explained in detail in Note 29.1.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 13 – LOANS AND ADVANCES TO BANKS

As of 31 December 2018 and 31 December 2017, loans and advances to banks at amortised cost are as follows:

	31 December 2018	31 December 2017
Demand deposits	709	1,556
Money market placements	160,616	167,831
Bank deposits	161,325	169,387
Trade finance	97,413	91,621
SME support program	57,493	80,009
Other loans and advances to banks	154,906	171,630
Loans and advances to banks, gross	316,231	341,017
Less: ECL/Impairment losses	(1,988)	-
Loans and advances to banks at amortised cost, net	**314,243**	**341,017**

NOTE 14 – LOANS AND ADVANCES TO CUSTOMERS

As of 31 December 2018 and 31 December 2017, loans and advances to customers at amortised cost are as follows:

	31 December 2018	31 December 2017
Trade finance	69,150	54,015
Project finance	66,783	75,783
Loans and advances to customers, gross	135,933	129,798
Less: ECL/Impairment losses	(2,508)	-
Loans and advances to customers at amortised cost, net	**133,425**	**129,798**

NOTE 15 – INVESTMENT SECURITIES

As of 31 December 2018 and 31 December 2017, investment securities are as follows:

	31 December 2018	31 December 2017
Debt investment securities measured at amortised cost:		
Bonds issued by financial institutions	19,173	-
Government bonds	3,645	-
Total debt investment securities measured at amortised cost	22,818	-
Less: ECL	(102)	-
Available-for-sale debt investment securities:		
Bonds issued by financial institutions	-	10,390
Government bonds	-	3,678
Investment securities, net	**22,716**	**14,068**

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 16 – PROPERTY AND EQUIPMENT

As of 31 December 2018 and 31 December 2017, property and equipment are as follows:

	31 December 2018	31 December 2017
Cost	8,583	8,585
Accumulated depreciation	(925)	(850)
Net book value	**7,658**	**7,735**

Movements in property and equipment are as follows:

	Land and buildings	Furniture, fixture and equipment	Motor vehicles	Total
31 December 2018				
Net book value at 1 January	7,706	28	1	7,735
Addition	-	21	-	21
Depreciation charge	(83)	(14)	(1)	(98)
Net book value at period end	**7,623**	**35**	**-**	**7,658**
31 December 2017				
Net book value at 1 January	9,570	51	18	9,639
Addition	-	10	-	10
Disposal	-	(15)	-	(15)
Transfers	(1,767)		-	(1,767)
Depreciation of disposals	-	15	-	15
Depreciation charge	(97)	(33)	(17)	(147)
Net book value at period end	**7,706**	**28**	**1**	**7,735**

As of 31 December 2018, property and equipment excluding the motor vehicles were insured against fire, theft and damage to the extent of EU 1,783 thousand. Motor vehicles are insured against accident to the extent of their acquisition cost.

At 31 December 2018, there is no impairment provision on property and equipment (31 December 2017: None).

At 31 December 2018, there were no capitalised borrowing costs related to the acquisition of property and equipment (31 December 2017: None).

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 17 – INVESTMENT PROPERTY

As of 31 December 2018 and 31 December 2017, investment properties are as follows:

	31 December 2018	31 December 2017
Cost	1,838	1,838
Less: Accumulated amortization	(95)	(76)
Net book value	**1,743**	**1,762**

Movements of investment properties are as follows:

	31 December 2018	31 December 2017
Net book value at 1 January	**1,762**	**-**
Reclassification from property and equipment	-	1,767
Depreciation charge	(19)	(5)
Net book value at period end	**1,743**	**1,762**

Investment property comprises three properties in the Bank's Head-quarters building. Rental income from investment property of EU 52 thousand (31 December 2017: EU 92 thousand) has been recognised in other operating income. Direct operating expenses for investment property that did not generated rental income amount to 5 EU thousand (2017: 5 EU thousand). There were no direct operating expenses for investment property that generated rental income.

At 31 December 2018, there is no impairment provision on investment property (31 December 2017: None).

NOTE 18 – INTANGIBLE ASSETS

As of 31 December 2018 and 31 December 2017, intangible assets are as follows:

	31 December 2018	31 December 2017
Cost	452	451
Less: Accumulated amortization	(382)	(336)
Net book value	**70**	**115**

Movements of intangible assets were as follows:

	31 December 2018	31 December 2017
Net book value at 1 January	**115**	**158**
Amortization charge	(48)	(50)
Additions	3	7
Net book value at period end	**70**	**115**

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 19 – OTHER ASSETS

As of 31 December 2018 and 31 December 2017, other assets are as follows:

	31 December 2018	31 December 2017
Receivables from clients (1)	1,056	279
Pre-paid expenses	29	45
Tax refunds	2	3
Other	17	26
Total	**1,104**	**353**

(1) According to the loan agreements made with the Bank's clients, the Bank receives over-due interest, front-end fees and commitment fees over the undrawn loan commitments and the expenses related with its loan operations. As of 31 December 2018, the Bank has over-due interest receivables and fee receivables amounting to EU 805 thousand and EU 251 thousand, respectively (31 December 2017: EU 6 thousand fee receivables and EU 273 thousand over-due interest).

E. LIABILITIES AND EQUITY

NOTE 20 – DEPOSITS FROM BANKS

As of 31 December 2018 and 31 December 2017, deposits from banks are as follows:

	31 December 2018	31 December 2017
Money market deposits	92,692	117,228
Total	**92,692**	**117,228**

NOTE 21 – EMPLOYEE BENEFITS

As of 31 December 2018 and 31 December 2017 employee benefit obligations are as follows:

	31 December 2018	31 December 2017
Pension plan liabilities	3,195	2,973
Annual leave pay liability	101	87
Reserve for employee severance indemnity	14	13
Total	**3,310**	**3,073**

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 21 – EMPLOYEE BENEFITS (Continued)

21.1. Pension plan liabilities

As of 31 December 2018 and 31 December 2017 pension plan liabilities are as follows:

	31 December 2018	31 December 2017
First pillar	1,239	1,194
Second pillar	1,270	1,243
Third pillar	112	72
Investment returns	471	372
Actuarial (gain)/loss	103	92
Total	**3,195**	**2,973**

Movements for the pension plan liabilities are as follows:

	31 December 2018	31 December 2017
1 January	**2,973**	**2,682**
Increase during the year	662	698
Benefits paid	(515)	(256)
Actuarial (gain)/losses for the period	9	10
Foreign exchange movements	66	(161)
At period end	**3,195**	**2,973**

The movement in the defined benefit obligation (disability pension liability) over the period is as follows:

	31 December 2018	31 December 2017
1 January	**92**	**87**
Current service cost	5	7
Interest cost	4	2
Actuarial Loss / (Gain)	-	1
Foreign exchange movements	2	(5)
At period end	**103**	**92**

The principal actuarial assumptions used were as follows (denominated in USD):

	31 December 2018 (%)	31 December 2017 (%)
Discount rate	4.0	4.0
Price inflation	2.1	2.1
Pay increase	3.6	3.6

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 21 – EMPLOYEE BENEFITS (Continued)

Mortality rate

EVK00 standard mortality rates for males and females are used for pre and after retirement mortality. The average life expectancy in years of a pensioner after retiring at age 60 for both men and women on the reporting date are as follows:

	31 December 2018	31 December 2017
Male	21.48	21.48
Female	24.40	24.40

The sensitivity analysis of defined benefit obligation of excess liabilities as of 31 December 2018 is as follows:

Assumption change	Pension excluding in-service disability	Salary continuation
Discount rate +1%	(19.3%)	(8.9%)
Discount rate -1%	25.6%	10.2%

21.2. Annual leave pay liability

The Bank's liability is the sum of the monetary values of each full-time professional staff member's annual leave entitlement which is calculated based on the monthly basic salaries.

Movements for the annual leave pay liability are as follows:

	31 December 2018	31 December 2017
1 January	**87**	**100**
Provision for the period (net)	21	(13)
Foreign exchange movements	(7)	-
At period end	**101**	**87**

21.3. Reserve for employee severance indemnity

The reserve has been calculated by estimating the present value of the future probable obligation of the Bank. IAS 19 requires actuarial valuation methods to be developed to estimate the entity's obligation for such benefits. Accordingly, the following actuarial assumptions were used in the calculation of the total liability:

	31 December 2018	31 December 2017
Discount rate (%)	3.60	4.67
Turnover rate to estimate the probability of retirement (%)	100.00	100.00

The principal actuarial assumption is that the current maximum liability will increase in line with inflation. Thus, the discount rate applied represents the expected real rate after adjusting for the effects of future inflation. As the maximum liability is revised semi-annually, the lower of maximum amount of TL 15,221 effective from 1 January 2018 (31 December 2017: TL 13,331) and gross monthly income of the staff member has been taken into consideration in calculating the reserve for employee termination benefits.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 21 – EMPLOYEE BENEFITS (Continued)

Because of being a multilateral development bank which is operative in different jurisdictions, the necessity of immunity from judicial proceedings has been recognized for the Bank by the Government of Turkey under the provision of the Article 4 of the Headquarters Agreement. Therefore, provision for severance payment is not calculated for the professional staff of the Bank. These financial statements include provision for severance payment only for the service staff employed by the Bank according to Turkish Labour Law.

Movements in the reserve for employment termination benefits are as follows:

	31 December 2018	31 December 2017
1 January	**13**	**-**
Transferred liability (1)	-	10
Benefits paid	-	-
Current service cost	1	1
Interest cost	-	1
Actuarial gain/(loss)	2	-
Foreign exchange movements	(2)	1
At period end	**14**	**13**

(1) The Bank decided to terminate the contract regarding administrative office work and take over six employees of the sub-contractor company into its payroll effective from 1 February 2017 with all retrospective legal and contractual rights for the term they provide service to the Bank under Turkish Labour Law.

NOTE 22 – OTHER LIABILITIES

As at 31 December 2018 and 31 December 2017 other liabilities are as follows:

	31 December 2018	31 December 2017
Unearned income (1)	786	1,105
Payables	20	27
Total	**806**	**1,132**

(1) The Bank defers the income from front-end commissions during the tenor specified in the loan agreements made with financial institutions and customers.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 23 – SHARE CAPITAL AND RESERVES

23.1. Share capital

The issued share capitals as of 31 December 2018 and 31 December 2017 are as follows:

	31 December 2018	31 December 2017
Authorized share capital	1,089,100	1,089,100
Less: unallocated share capital	-	-
Subscribed share capital	**1,089,100**	**1,089,100**
Less: callable share capital	(762,350)	(762,350)
Less: shares called but not yet due	(3,040)	(7,320)
Paid-in share capital	**323,710**	**319,430**

As at 31 December 2018 share capital structure of the Bank showing the number of shares, the amount subscribed by each member, including their respective callable and payable as well as the amount paid-in is as follows:

	Shares	Subscribed	Callable	Payable	Paid-in
Islamic Republic of Iran (1)	3,333	333,333	233,333	-	100,000
Islamic Republic of Pakistan (1)	3,333	333,333	233,333	-	100,000
Republic of Turkey (1)	3,333	333,333	233,333	-	100,000
Islamic Republic of Afghanistan	500	50,000	35,000	2,400	12,600
Republic of Azerbaijan	325	32,500	22,750	-	9,750
Kyrgyz Republic	66	6,600	4,600	640	1,360
Total	**10,891**	**1,089,100**	**762,350**	**3,040**	**323,710**

(1) Total number of shares, subscribed capital and callable capital of the three founding members are equal and 10,000; EU 1,000,000 thousand and EU 700,000 thousand, respectively.

Out of the subscribed capital, EU 762,350 thousand may become callable (31 December 2017: EU 762,350 thousand), upon a unanimous decision of the Board of Governors, by the member countries in such manner and on such terms as deemed fit by the Board of Governors. The paid-in capital of EU 323,710 thousand (31 December 2017: EU 319,430 thousand) is reflected at its cost.

Total share capital paid-in during 2018 amounts to EU 4,280 thousand which was paid by Islamic Republic of Afghanistan, Republic of Azerbaijan and Kyrgyz Republic are EU 2,400 thousand, EU 1,560 thousand and EU 320 thousand, respectively (2017: EU 4,280 thousand which was paid by Islamic Republic of Afghanistan, Republic of Azerbaijan and Kyrgyz Republic are EU 2,400 thousand, EU 1,560 thousand and EU 320 thousand, respectively).

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 23 – EQUITY (Continued)

23.2. Revaluation reserves

Revaluation reserves as of 31 December 2018 and 31 December 2017 are as follows:

	31 December 2018	31 December 2017
Reserve for employee severance indemnity	(3)	-
Net unrealized (losses)/gains from changes in fair value of AFS debt securities	-	49
Total	**(3)**	**49**

23.3. Other reserves and Retained earnings

Other reserves and Retained earnings as of 31 December 2018 and 31 December 2017 are as follows:

	31 December 2018	31 December 2017
Retained earnings	(2,576)	-
Net profit for the period	9,509	9,771
General reserves	53,867	44,096
Total	**60,800**	**53,867**

In accordance with Article 27 of the Agreement, the Board of Governors determine annually what part of the net income of the Bank from ordinary capital operations shall be allocated to reserves, provided that no part of the net income of the Bank shall be distributed to members by way of profit until the General Reserves of the Bank shall have attained the level of 25% of the subscribed capital.

In its annual meeting held on 28 June 2018, the Board of Governors of the Bank resolved to approve allocation of prior year's net profit amounting to EU 9,771 thousands to the reserves of the Bank.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

F. PERFORMANCE FOR THE PERIOD

NOTE 24 – NET INTEREST INCOME

	31 December 2018	31 December 2017
Interest income		
Loans and advances to banks	8,656	8,741
- money market placements	3,750	3,048
- other loans and advances	4,906	5,693
Loans and advances to customers	4,708	4,228
Investment securities at amortised cost (2017: available-for-sale)	1,106	668
Total interest income	**14,470**	**13,637**
Interest expense		
Deposits from banks	(695)	(795)
Pension plan liabilities (1)	(151)	(125)
Total interest expense	**(846)**	**(920)**
Net interest income	**13,624**	**12,717**

(1) As the Bank keeps assets of the pension plan under its treasury investment portfolio, interest is accrued on the liabilities to the pension plan (Note 7.19.2).

The amounts reported above are calculated using the effective interest method.

NOTE 25 – NET FEE AND COMMISSION INCOME

	31 December 2018	31 December 2017
Fee and commission income		
From banks	181	90
- front-end fees	110	90
- pre-payment fees	71	-
From customers	337	256
- front-end fees	255	214
- commitment fees	82	41
- other fees	-	1
Total fee and commission income	**518**	**346**
Commissions paid to banks	(3)	(4)
Total fee and commission expense	**(3)**	**(4)**
Net fee and commission income	**515**	**342**

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 26 – OTHER OPERATING INCOME

	31 December 2018	31 December 2017
Rent income from investment property	52	92
Other	6	-
Total other operating expenses	**58**	**92**

NOTE 27 – OPERATING EXPENSES

	31 December 2018	31 December 2017
Salaries and benefits	2,705	3,074
Contributions to defined contribution plans (1)	413	478
Other contributions (2)	71	89
Staff development expenses	4	1
Total personnel expenses	**3,193**	**3,642**
Office occupancy expenses (3)	101	125
Operational subscriptions expenses	79	80
Travel and accommodation expenses	75	99
Equipment, maintenance and support	72	75
Consultant and third party fees	24	40
Communication expenses	12	21
Other	44	53
Other administrative expenses	**407**	**493**
Depreciation and amortization	165	202
Total operating expenses	**3,765**	**4,337**

(1) Contributions are comprised of the contributions made by the Bank on behalf of the employees for the Bank's Pension Plan (Note 7.19.2) and Turkish State Social Security Plan (Note 7.19.1).

(2) Other contributions are comprised of life insurance and medical insurance contributions made by the Bank on behalf of the employees, as well as income tax on emoluments.

(3) Direct operating expenses for investment property that did not generate rental income amount to 5 EU thousand (2017: 5 EU thousand). There were no direct operating expenses for investment property that generated rental income.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

G. OTHER INFORMATION

NOTE 28 – TRANSITION DISCLOSURES

28.1. Classification and measurement of financial instruments

The measurement category and the carrying amount of financial assets and liabilities in accordance with IAS 39 and IFRS 9 at 1 January 2018 are as follows:

	IAS 39		IFRS 9	
	Measurement category	**Carrying amount**	**Measurement category**	**Carrying amount**
Financial assets				
Loans and advances to banks	Amortised cost (Loans and receivables)	341,017	Amortised cost	338,979
Loans and advances to customer	Amortised cost (Loans and receivables)	129,798	Amortised cost	129,326
Investment securities	FVOCI (Available for sale)	14,068	Amortised cost	13,953
Derivative financial instruments	FVPL (Held for trading)	663	FVPL (Mandatory)	663
Financial liabilities				
Deposits from banks	Amortised cost	117,228	Amortised cost	117,228
Derivative financial instruments	FVPL (Held for trading)	732	FVPL (Held for trading)	732

28.2. Reconciliation of statement of financial position balances from IAS 39 to IFRS 9

The Bank performed a detailed analysis of its business models for managing financial assets and analysis of their cash flow characteristics. Please refer to note 6.1 for more detailed information regarding the new classification requirements of IFRS 9.

As of 1 January 2018, debt securities classified as "Investment securities: Available-for-sale" in the prior year financial statements amounting to EU 14,068 thousands are classified into "Investment securities at amortised cost" due to the fact that they are assessed within the scope of a business model whose objective is to hold assets in order to collect contractual payments and the contractual terms of the financial asset meet the condition of giving rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 28 – TRANSITION DISCLOSURES (Continued)

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

	IAS 39 carrying amount 31 December 2017	**Reclassification Effect**	**Remeasurement Effect**	**IFRS 9 carrying amount 1 January 2018**
Amortised cost				
Loans and advances to banks				
Opening balance under IAS 39	341,017			
Remeasurement: ECL allowance			(2,038)	
Closing balance under IFRS 9				338,979
Loans and advances to customers				
Opening balance under IAS 39	129,798			
Remeasurement: ECL allowance			(472)	
Closing balance under IFRS 9				129,326
Investment securities				
Opening balance under IAS 39	-			
Addition: From Available for sale (IAS 39)		14,068		
Remeasurement: from FV to Amortised cost			(49)	
Remeasurement: ECL allowance			(66)	
Closing balance under IFRS 9				13,953
Total financial assets measured at amortised cost	**470,815**	**14,068**	**(2,625)**	**482,258**
Fair value through other comprehensive income (FVOCI)				
Investment securities – Available for Sale financial assets				
Opening balance under IAS 39	14,068			
Subtraction: To amortised cost (IFRS 9)		(14,068)		
Closing balance under IFRS 9				-
Total financial assets measured at FVOCI	**14,068**	**(14,068)**	**-**	**-**

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 28 – TRANSITION DISCLOSURES (Continued)

28.3. Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

The following table reconciles the prior period's closing impairment allowance measured in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected loss model at 1 January 2018:

Measurement category	Loan loss allowance under IAS 39	Reclassification	Remeasurement	Loan loss allowance under IFRS 9
Loans and receivables (IAS 39) / Financial assets at amortised cost (IFRS 9)				
Loans and advances to banks	-	-	2,038	2,038
Loans and advances to customers	-	-	472	472
Investment securities	-	-	66	66
Total	**-**	**-**	**2,576**	**2,576**

Due to first time adoption of IFRS 9, the total expected credit losses calculation impact of EU 2,576 thousand was recognised in opening retained earnings at 1 January 2018.

As of 1 January 2018, there exists no loan balance that does not meet the condition of giving rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

NOTE 29 – COMMITMENTS AND CONTINGENT LIABILITIES

In the normal course of business activities, the Bank undertakes various commitments and incurs certain contingent liabilities that are not presented in the financial statements.

29.1. Commitments under derivative instruments

As of 31 December 2018 and 31 December 2017, breakdown of notional amounts of derivative transactions is as follows:

	31 December 2018					
	US Dollar	Euro	Chinese Yuan	British Pound	Japanese Yen	Total
Derivatives held for trading						
Currency swaps	-	-	39,786	29,108	28,821	97,715
Total purchases	**-**	**-**	**39,786**	**29,108**	**28,821**	**97,715**
Derivatives held for trading						
Currency swaps	(13,979)	(83,190)	-	-	-	(97,169)
Total sales	**(13,979)**	**(83,190)**	**-**	**-**	**-**	**(97,169)**
Off-balance sheet net notional position	**(13,979)**	**(83,190)**	**39,786**	**29,108**	**28,821**	**546**

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 29 – COMMITMENTS AND CONTINGENT LIABILITIES (Continued)

	31 December 2017					
	US Dollar	**Euro**	**Chinese Yuan**	**British Pound**	**Japanese Yen**	**Total**
Derivatives held for trading						
Currency swaps	-	-	39,788	28,471	26,392	94,651
Total purchases	**-**	**-**	**39,788**	**28,471**	**26,392**	**94,651**
Derivatives held for trading						
Currency swaps	(30,089)	(64,371)	-	-	-	(94,460)
Total sales	**(30,089)**	**(64,371)**	**-**	**-**	**-**	**(94,460)**
Off-balance sheet net notional position	**(30,089)**	**(64,371)**	**39,788**	**28,471**	**26,392**	**191**

29.2. Credit related and other commitments

	31 December 2018	31 December 2017
Credit limit commitments [(1)]	5,592	12,632
Other commitments [(2)]	5	5
Total	**5,597**	**12,637**

(1) The Bank has credit limit commitments to the customers due to project finance loans.
(2) Other commitments comprised of rent guarantees of the Bank for the expatriate staff members.

(Amounts expressed in thousands of ECO Unit ("EU") unless otherwise indicated.)

NOTE 30 – SEGMENT ANALYSIS

The Bank is a multilateral financial institution dedicated to promoting and facilitating private and public sector investments, cooperation and development in member states and fostering the growth of intra-regional trade. The Bank operates in a specific geographical area and the primary reporting format for business segments includes Banking and Treasury operations. Banking activities represent loans to financial institutions for SME support and trade finance, loans to customers for projects, trade and corporate finance. Treasury activities include raising debt finance, investing surplus liquidity, managing the Bank's market risk.

31 December 2018	**Banking**	**Treasury**	**Total**
Interest income	9,614	4,856	14,470
Fee and commission income	518	-	518
Total segment revenues	**10,132**	**4,856**	**14,988**
Interest expense	(433)	(413)	(846)
Fee and commission expense	-	(3)	(3)
Foreign exchange gain	-	1,107	1,107
Other operating income	39	19	58
Operating expenses	(2,792)	(973)	(3,765)
Segment income before impairment	**6,946**	**4,593**	**11,539**
Net impairment (loss)/reversal	(1,931)	(99)	(2,030)
Net income for the period	**5,015**	**4,494**	**9,509**
Segment assets	**294,405**	**187,354**	**481,759**
Segment liabilities	**54,778**	**42,474**	**97,252**

31 December 2017	**Banking**	**Treasury**	**Total**
Interest income	9,921	3,716	13,637
Fee and commission income	346	-	346
Total segment revenues	**10,267**	**3,716**	**13,983**
Interest expense	(407)	(513)	(920)
Fee and commission expense	-	(4)	(4)
Foreign exchange gain	-	957	957
Other operating income	61	31	92
Operating expenses	(3,293)	(1,044)	(4,337)
Segment income before impairment	**6,628**	**3,143**	**9,771**
Net impairment reversal	-	-	-
Net income for the period	**6,628**	**3,143**	**9,771**
Segment assets	**308,071**	**187,440**	**495,511**
Segment liabilities	**36,966**	**85,199**	**122,165**

NOTE 31 – RELATED PARTY TRANSACTIONS

For the purpose of this report, the members of the Bank (Note 23.1) and the Bank's key management personnel are referred to as related parties.

The Bank's key management personnel are comprised of the President and two Vice Presidents. They are entitled to a staff compensation package that includes salary, medical and life insurance, participation in the Bank's pension plan and other short term benefits.

The salaries and other benefits paid to key management personnel amount to EU 522 thousand as of 31 December 2018 (31 December 2017: EU 540 thousand). This comprises salary and employee benefits of EU 445 thousand (31 December 2017: EU 460 thousand) and contributions made by the Bank on behalf of the management personnel of EU 77 thousand (31 December 2017: EU 80 thousand). Key management personnel do not receive post-employment benefits like termination benefits, any share-based payments or other long term benefits, except lump sum pension payment.

The members of the Board of Directors are not personnel of the Bank and do not receive any fixed term salaries nor any staff benefits.

NOTE 32 – SUBSEQUENT EVENTS

None.

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