TÜRKİYE
KALKINMA BANKASI A.Ş.
AND ITS SUBSIDIARY

Consolidated Financial Statements
As at and for the Year Ended
31 December 2017
With Independent Auditors' Report

7 August 2018

This report contains 5 pages of independent auditors' report on consolidated financial statement and 54 pages of consolidated financial statements and notes to the consolidated financial statements.

Türkiye Kalkınma Bankası Anonim Şirketi and Its Subsidiary

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of Türkiye Kalkınma Bankası A.Ş.

Qualified Opinion

We have audited the accompanying consolidated financial statements of Türkiye Kalkınma Bankası A.Ş. (the "Bank") and its subsidiary (together referred to as "the Group"), which comprise the consolidated statement of financial position as at 31 December 2017, the consolidated statement of profit or loss, the consolidated statement of other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and the notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Qualified Opinion

The Bank's investment in Maksan Malatya Makina Sanayi A.Ş. ("Maksan"), Istanbul Venture Capital Investment ("IVCI") and Türk Suudi Holding A.Ş. ("Türk Suudi Holding"), the associates accounted for by the equity method, are carried at TL 5,014 Thousand, TL 37,305 Thousand and TL 6,325 Thousand, respectively on the consolidated statement of financial position as at 31 December 2017, and Bank's share of Maksan's, IVCI's and Türk Suudi Holding's net income of TL 203 Thousand, TL 11,336 Thousand and TL 1,025 Thousand, respectively, are included in Bank's income for the period then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of Bank's investment in Maksan, IVCI and Türk Suudi Holding as at 31 December 2017 and Bank's share of Maksan's, IVCI's and Türk Suudi Holding's net income for the period. Additionally, we were unable to obtain the audited financial information of Arıcak Turizm ve Ticaret A.Ş. ("Arıcak"), a subsidiary of the Bank, which is consolidated in the consolidated financial statement of the Group as at 31 December 2017. Total asset and net income for the period at Arıcak is TL 8,643 Thousand and TL 478 Thousand respectively. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.We conducted our audit in accordance with International Standards on Auditing ("ISAs"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (the "IESBA Code") together with ethical requirements that are relevant to our audit of the financial statements in Turkey, 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 qualified opinion.

Key Audit Matter

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current year. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in Basis for Qualified Opinion section we have determined the matters described below the key audit matter to be communicated in our report.

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Impairment of loans and advances to customers

Refer to "Significant accounting policies" Section(s) and note 6 to the consolidated financial statements relating to the impairment of loans and advances to customers.

The key audit matter	How the matter was addressed in our audit
The appropriateness of loan loss provision is a key area of judgment for management. The identification of impairment and the determination of the recoverable amount are an inherently uncertain process involving various assumptions and factors including the financial condition of the counterparty, expected future cash flows, observable market prices and expected net selling prices. The use of different modelling techniques and assumptions could produce significantly different estimates of loan loss provisions. Impairment of loans and advances to customers was considered to be a key audit matter, due to the significance of the estimates and the level of judgment applied by management.	We have performed the following audit procedures: - We tested the design and operating effectiveness of the controls on lending, collateralization, collection, follow-up, classification and impairment calculations. - We performed loan reviews for selected loan samples, which include a detailed examination of loan files and related information. In this context, the current status of the loan customer has been evaluated. - For loan loss provisions calculated on an individual basis, we tested the assumptions underlying the impairment identification and quantification including forecasts of future cash flows, valuation of underlying collected and estimates of recovery on default. - For loan loss provision calculated on a collective basis, we tested the underlying models including the appropriateness and accuracy of the inputs to those models, such as recovery and cure rates. - Additionally, we also evaluated the adequacy of consolidated financial statement disclosures including disclosures of key assumptions and judgements.

Emphasis of Matter - comparative information

We draw attention to Note 2.10 to the consolidated financial statements which indicates that the comparative information presented as at and for the year ended 31 December 2016 has been restated. Our opinion is not modified in respect of this matter.

Other Matter

The consolidated financial statements of the Group as at and for the year ended 31 December 2016 excluding the adjustments described in Note 2.10 to the consolidated financial statements were audited by another auditor who expressed a qualified opinion due to due to lack of audited financial information of subsidaries and associates, on those financial statements on 28 April 2017.

As part of our audit of the consolidated financial statements as at and for the year ended 31 December 2017, we audited the adjustments described in Note 2.10 that were applied to restate the comparative information presented as at and for the year ended 31 December 2016 and the statement of financial position as at 1 January 2016. We were not engaged to audit, review, or apply any procedures to the consolidated financial statements for the year ended 31 December 2016 or to the consolidated statement of financial position as at 1 January 2016, other than with respect to the adjustments described in Note 2.10 to the consolidated financial statements. Accordingly, we do not express an opinion or any other form of assurance on those respective financial statements taken as a whole. However, in our opinion, the adjustments described in Note 2.10 are appropriate and have been properly applied.

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

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

In preparing the consolidated financial statements, management is responsible for assessing the Group'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 Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's 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 consolidated 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 consolidated 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 Group'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 Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated 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 auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

• Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

• Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current year and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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

Erdal Tıkmak
Partner

Istanbul, 7 August 2018

TÜRKİYE KALKINMA BANKASI ANONİM ŞİRKETİ AND ITS SUBSIDIARY
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS OF 31 DECEMBER 2017

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

	Notes	31 December 2017	31 December 2016 (Restated*)
ASSETS			
Cash and deposits with banks and other financial institutions	4	1,335,274	1,265,476
Balances with Central Bank	4	626	1,020
Money market placements	4	326,024	10,505
Loans and advances to customers	6	6,373,966	4,989,053
Loans and advances to financial institutions	6	528,815	400,037
Investment securities:		257,341	213,815
- Available-for-sale	*5*	*257,341*	*193,400*
- Held-to-maturity	*5*	-	*20,415*
Investments in associates	7	48,645	36,071
Premises and equipment	8	38,033	42,225
Investment properties	9	8,868	8,912
Intangible assets	10	1,048	1,531
Deferred tax asset	14	11,805	3,982
Other assets	11	44,687	46,466
Total assets		**8,975,132**	**7,019,093**
LIABILITIES AND EQUITY			
LIABILITIES			
Obligations under repurchase agreements		130	351
Funds borrowed	12	7,584,520	5,800,509
Other liabilities and provisions	13	60,813	402,220
Income taxes payable	14	9,063	7,543
Total liabilities		**7,654,526**	**6,210,623**
EQUITY			
Equity attributable to equity holders of the parent			
Share capital issued	15	776,911	436,911
Share premium		1,582	1,491
Actuarial gain		1,864	1,730
Unrealized gains/(losses) on available-for-sale investments, net of tax		(286)	(101)
Legal reserves		32,150	32,150
Retained earnings		508,385	336,289
Total equity		**1,320,606**	**808,470**
Total liabilities and equity		**8,975,132**	**7,019,093**

(*) See note 2.10.

The accompanying policies and explanatory notes are an integral part of these consolidated financial statements.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

	Notes	1 January – 31 December 2017	1 January – 31 December 2016
Interest income			
Interest on loans and advances		259,665	171,062
Interest on securities	19	16,421	11,972
Interest on deposits with banks and other financial institutions		67,540	29,490
Interest on other money market placements		31,345	6,509
Other interest income		38	858
Total interest income		**375,009**	**219,891**
Interest expense			
Interest on money market operations		(1,819)	(42)
Interest on funds borrowed and deposits from other banks		(93,768)	(53,988)
Other interest expense		-	(6)
Total interest expense		**(95,587)**	**(54,036)**
Net interest income		**279,422**	**165,855**
Fees and commissions and other operating income			
Fees and commissions income	22	13,328	20,001
Fees and commissions expenses	22	(610)	(405)
Net fees and commissions income		**12,718**	**19,596**
Foreign exchange gains		(3,639)	5,325
Gains on securities		(3)	9
Other operating income	20	3,526	9,419
Other operating expenses	21	(90,902)	(84,020)
(Provisions for) / recoveries from impairment of loans and other assets		(13,610)	(17,751)
Operating profit		**187,512**	**98,433**
Income from associates	8	12,869	5,116
Profit before income tax		**200,381**	**103,549**
Income tax expense	14	(28,285)	(21,645)
Profit for the year		**172,096**	**81,904**
Profit attributable to:			
Equity holders of the parent		172,096	81,904
Earnings per share (per 100 shares) (Full TL)	17	**0.3780**	**0.5119**

The accompanying policies and explanatory notes are an integral part of these consolidated financial statements.

TÜRKİYE KALKINMA BANKASI ANONİM ŞİRKETİ AND ITS SUBSIDIARY
CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2017

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

	Notes	1 January – 31 December 2017	1 January – 31 December 2016
Profit for the year		**172,096**	**81,904**
Other comprehensive income			
Items that will not be reclassified subsequently to profit or loss:			
Actuarial gain/(loss)		168	1,048
Tax effect of actuarial gain/(loss)		(34)	(210)
Items that may be reclassified subsequently to profit or loss:			
Net value gains / (losses) on available-for-sale financial assets		(231)	(108)
Tax effect of net value gains/ (losses) on available for sale financial assets		46	22
Other comprehensive income / (loss) for the year, net of tax		**(51)**	**752**
Total comprehensive income for the year		**172,045**	**82,656**
Total comprehensive income attributable to:			
Equity holders of the parent		**172,045**	**82,656**
Non-controlling interest		-	-

The accompanying policies and explanatory notes are an integral part of these consolidated financial statements.

TÜRKİYE KALKINMA BANKASI ANONİM ŞİRKETİ AND ITS SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2017

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

	Share capital	Adjustment to share capital	Share Premium	Actuarial gain/(loss)	Unrealized gains/(losses) on available-for-sale investments	Legal Reserves	Retained earnings	Total Equity
At 31 December 2015, reported	**160,000**	**1,290,923**	**1,557**	**892**	**(15)**	**76,216**	**(803,759)**	**725,814**
Offset of statutory accumulated deficit against adjustment to share capital (Note 2.10)	-	(1,014,012)	(66)	-	-	(44,066)	1,058,144	-
At 31 December 2015, restated	**160,000**	**276,911**	**1,491**	**892**	**(15)**	**32,150**	**254,385**	**725,814**
Profit for the year	-		-	-	-	-	81,904	81,904
Actuarial gain/(loss):	-		-	-	-	-	-	-
Gains/(Losses) arising during the year	-		-	1,048	-	-	-	1,048
Available for sale financial assets:	-		-	-	-	-	-	-
Gains/(Losses) arising during the year	-		-	-	(108)	-	-	(108)
Less: Transfer to statement of income	-		-	-	-	-	-	-
Income tax relating to components of other comprehensive income	-		-	(210)	22	-	-	(188)
Other comprehensive income	-		-	838	(86)	-		752
Total comprehensive income for the year	-		-	838	(86)	-	81,904	82,656
At 31 December 2016	**160,000**	**276,911**	**1,491**	**1,730**	**(101)**	**32,150**	**336,289**	**808,470**
Profit for the year	-		-	-	-	-	172,096	172,096
Actuarial gain/(loss):	-		-	-	-	-	-	-
Gains/(Losses) arising during the year	-		-	168	-	-	-	168
Available for sale financial assets:	-		-	-	-	-	-	-
Gains/(Losses) arising during the year	-		-	-	(231)	-	-	(231)
Less: Transfer to statement of income	-		-	-	-	-	-	
Income tax relating to components of other comprehensive income	-		-	(34)	46	-	-	12
Other comprehensive income	-		-	134	(185)	-	-	(51)
Total comprehensive income for the year	-		-	134	(185)	-	172,096	172,045
Capital increase by cash	340,000		91	-	-	-	-	340,091
At 31 December 2017	**500,000**	**276,911**	**1,582**	**1,864**	**(286)**	**32,150**	**508,385**	**1,320,606**

The accompanying policies and explanatory notes are an integral part of these consolidated financial statements.

TÜRKİYE KALKINMA BANKASI ANONİM ŞİRKETİ AND ITS SUBSIDIARY
CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2017

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

	Notes	1 January – 31 December 2017	1 January – 31 December 2016 (Restated*)
Cash flows from operating activities			
Interest received		357,108	205,425
Interest paid		(88,859)	(48,056)
Fees and commissions received		13,328	20,001
Fees and commissions paid		(610)	(405)
Trading (income)/losses		(3)	9
Recoveries of impairment of loan and other assets		(13,610)	-
Cash payments to employees and other parties		(63,610)	(58,671)
Unrealized foreign exchange gains		14,426	76,519
(Gain) on sale of premises and equipment		(2,076)	(347)
Other operating activities		(14,520)	(64,650)
Income taxes paid		(37,950)	(21,341)
Cash flows from operating activities before changes in operating assets and liabilities		**163,624**	**108,484**
Changes in operating assets and liabilities			
Net (increase)/decrease in loans and advances to customers		(531,877)	(733,946)
Net (increase)/decrease in loans and advances to financial institutions		(128,778)	(28,891)
Net (increase)/decrease in other assets		4,380	2,152
Net increase/(decrease) in other liabilities		(341,663)	355,314
Net increase/(decrease) in money market deposits		(203)	125
Proceeds from funds borrowed		846,735	1,005,607
Net cash used in operating activities		**12,218**	**708,845**
Cash flows from investing activities			
Purchases of available for sale securities		(173,407)	(118,396)
Proceeds from sale and redemption of available for sale securities		122,908	87,824
Purchases of held to maturity investments		-	5
Proceeds from redemption of held to maturity investments		20,415	37
Purchases of premises and equipment	8	(78)	(1,860)
Proceeds from sale of premises and equipment		4,621	353
Purchases of investment property		(416)	
Purchases of intangible assets		(314)	(1,355)
Purchases of equity participations		(1,457)	(8,939)
Net cash provided / (used in) from investing activities		**(27,728)**	**(42,331)**
Cash flows from financing activities			
Capital increase		340,000	-
Net cash provided by / (used in) financing activities		**340,000**	**-**
Effect of net foreign exchange difference		57,465	49,143
Net increase/(decrease) in cash and cash equivalents		**381,955**	**715,657**
Cash and cash equivalents at the beginning of the year	4	1,275,652	559,995
Cash and cash equivalents at the end of the year	4	**1,657,607**	**1,275,652**

(*) See note 2.10.

The accompanying policies and explanatory notes are an integral part of these consolidated financial statements.

1. GENERAL INFORMATION ABOUT THE BANK

The Bank was established on 27 November 1975 according to the Decree Based on Law numbered 13 as a related institution of the Ministry of Trade and Technology with the legal title of "Devlet Sanayi ve İşçi Yatırım Bankası A.Ş.". Some adjustments were made on the status of the Bank with the Decree Based on Law numbered 165 dated 14 November 1983. On 15 July 1988, its legal title was changed to Türkiye Kalkınma Bankası A.Ş. by being associated to the Prime Ministry in the context of the Decree Law numbered 329 and in parallel with the developments in its activities. The Bank had become a development and investment bank that provides financing support to companies in tourism sector as well as trade sector by taking over T.C. Turizm Bankası A.Ş. with all of its assets and liabilities with the decision of Supreme Planning Council dated 20 January 1989 and numbered 89/T-2. Also with the Decree Law numbered 401 dated 12 February 1990, some of the articles related to the Bank status were changed. With the Law dated 14 October 1999 and numbered 4456, Decree Law numbered 13, 165, 329 and 401 were revoked and the establishment and operating principles of the Bank were rearranged.

The Bank is subject to the registered capital system. 99.08% of the capital is owned by the Undersecretariat of Treasury of the Turkish Republic and the remaining shares are quoted on the Borsa İstanbul (“BIST”).

The objectives of the Bank are set out in the Law No 4456. These objectives are to provide enterprises in the status of joint-stock company with financial and operational support by means of loans and equity participations within the concept of profitability and efficiency, to direct domestic and foreign savings towards investments aimed at development, to contribute to the development of the capital market, to finance domestic, foreign and international joint investments and to carry out all functions of development and investment banking operations.

The objectives of the Bank are set out in the Law No 4456. These objectives are to provide enterprises in the status of joint-stock company with financial and operational support by means of loans and equity participations within the concept of profitability and efficiency, to direct domestic and foreign savings towards investments aimed at development, to contribute to the development of the capital market, to finance domestic, foreign and international joint investments and to carry out all functions of development and investment banking operations.

The Bank currently provides investment banking services mainly to the financing of manufacturing, tourism, education, health and energy sectors. Besides supplying loans in medium and long terms to the above mentioned sectors, the Bank also participates in other activity fields such as project assessment, leasing, rehabilitation, equity participation, fund management, banking operations and training activities.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Statement of Compliance

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

The consolidated financial statements of the Group were authorized for issuance by the management on 7 August 2018.

2.2. Basis of Preparation

These consolidated financial statements have been prepared on the historical cost except for those assets and liabilities measured at fair value. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

2.3 Basis of Presentation of Consolidated Financial Statements

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS). These consolidated financial statements have been prepared under the historical cost convention, except for available-for-sale securities, financial assets at fair value through profit and loss and derivative financial instruments that have been measured at fair value.

The Bank and its subsidiary are incorporated in Turkey and maintain their books of account and prepare their statutory financial statements in accordance with the regulations on accounting and reporting framework and accounting standards which are determined by the provisions of Turkish Banking Law and accounting standards promulgated by the other relevant law and regulations. The foreign associates maintain their books of account and prepare their statutory financial statements in their local currencies and in accordance with the regulations of the countries in which they operate. The accompanying financial statements differ from the financial statements prepared for statutory purposes in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with IFRS, which are not recorded in the accounting books of Group's entity.

2.4 Inflation accounting

The financial statements of the Bank and its subsidiary for the periods before 1 January 2006 were adjusted to compensate for the effect of changes in the general purchasing power of the Turkish Lira based on IAS 29 "Financial Reporting in Hyperinflationary Economies". Turkish Economy is accepted to come off its highly inflationary status as of 1 January 2006. Based on this consideration, IAS 29 has not been applied in the preparation of the consolidated financial statements since 1 January 2006. Amounts expressed in the measuring unit current at 31 December 2005 were treated as the basis for the carrying amounts after 1 January 2006.

2.5 Basis of Consolidation

The consolidated financial statements incorporate the financial statements of the Bank and entity controlled by the Bank (its subsidiary). Control is achieved where the Bank has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 Basis of Consolidation (continued)

The subsidiary included in consolidation and effective shareholding percentages of the Group as of 31 December 2017 and 2016 are as follows:

	Place of Incorporation	Effective Shareholding %		Voting Rights %	
		31 December 2017	31 December 2016	31 December 2017	31 December 2016
Arıcak Turizm ve Ticaret A.Ş. (“Arıcak”)	İstanbul	99.71%	99.71%	100.00%	100.00%

The Bank’s investment other than that stated above, in which the shareholding is 20% or greater, are accounted for using the equity method. Other investments and certain minor subsidiaries and associates are accounted for at cost.

2.6 Investments in associates

The Group’s investments in associates accounted for under the equity method of accounting is as follows:

	Place of Incorporation	Effective Shareholding %		Voting Rights %	
		31 December 2017	31 December 2016	31 December 2017	31 December 2016
Istanbul Venture Capital Investment (“IVCI”)	Luxembourg	6.25%	6.25%	11.11%	11.11%
Maksan Malatya Makina Sanayi A.Ş. (“Maksan”)	Malatya	31.14%	31.14%	20.00%	20.00%
Türk Suudi Holding A.Ş.	Istanbul	24.69%	24.69%	10.00%	10.00%

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting, except when the investment is classified as held for sale, in which case it is accounted for under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Under the equity method, an investment in associate is initially recognized in the consolidated statement of financial position at cost and adjusted thereafter to recognize the Group’s share of the profit or loss and other comprehensive income of the associate. When the Group's share of losses of an associate exceeds the Group's interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognizing its share of further losses. Additional losses are recognized only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

When necessary, the entire carrying amount of the investment (including goodwill) is tested for impairment in accordance with IAS 36 Impairment of Assets as a single asset by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount. Any impairment loss recognized forms part of the carrying amount of the investment. Any reversal of that impairment loss is recognized in accordance with IAS 36 to the extent that the recoverable amount of the investment subsequently increases.

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

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.7 Use of Estimates and Judgments

The preparation of the financial statements in accordance with IFRS, including International Accounting Standards (IAS), requires management to make estimates and assumptions that are reflected in the measurement of income and expenses in the profit and loss statement and in the carrying value of assets and liabilities in the balance sheet, and in the disclosure of information in the notes to the financial statements. Management do exercise judgment and make use of information available at the date of the preparation of the financial statements in making these estimates. The actual future results from operations in respect of the areas where these judgments and estimates have been made may in reality be different than those estimates. This may have a material effect on the financial statements. The judgments and estimates that may have a significant effect on amounts recognized in the financial statements are discussed in the relevant sections below.

2.8 Functional and Presentation Currency

Functional currency of the Bank and its subsidiary is Turkish Lira (TRY). Until 31 December 2004, the date at which the Group considers that the qualitative and quantitative characteristics necessitating restatement pursuant to IAS 29 (“Financial Reporting in Hyperinflationary Economies”) were no longer applicable, the financial statements of these companies were restated for the changes in the general purchasing power of TRY based on IAS 29, which requires that financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date and the corresponding figures for previous periods be restated in the same terms.

The functional currency of the Bank’s foreign associate is its local currency.

2.9 Foreign Currency Transactions and Translation

Transactions in currencies other than the entity’s functional currency (foreign currencies) are recorded at the rates of exchange prevailing at the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing at the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Exchange differences are recognized in profit or loss in the period in which they arise.

Foreign currency translation rates used by the Group as of respective year-ends are as follows:

	EUR/TRY	**USD/TRY**
31 December 2016	3.685	3.503
31 December 2017	4.499	3.762

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.10 Changes in accounting policies, comparative information and restatement of prior periods' financial statements

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Group entities.

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current period.

The Group has started to present change in money market deposits and proceeds from funds borrowed in operating activities in the statement of cash flow and prior period cash flow for the period ended 31 December 2016 is restated. Net cash used in operating activities are changed to TL 708,845 from TL (296,878) and net cash provided from financing activities to nil from TL 1,005,732.

Adjustment to share capital which arose from the restatement of share capital and reserves in accordance with IAS 29 was offset against accumulated deficit and reserves in the statutory financial statements in 31 December 2002 and 31 December 2014.

2.11 Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation and any accumulated impairment losses. Land is not depreciated and carried at cost less accumulated impairment.

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

Gain or loss arising from the disposal or retirement of an item of premises and equipment is determined as the difference between the sales proceeds and the carrying amount of that asset and is recognized in profit or loss.

Ordinary maintenance and repair expenses on premises and equipment items are recognized as expenses. Investment expenditures that increase the future benefit by enhancing the capacity of tangible assets are capitalized. Investment expenditures include cost items that extend the useful life of the asset, increase the servicing capabilities of the asset, improve the quality of goods or services produced or reduce the costs.

Tangible fixed assets are amortized by using the straight-line method over their estimated useful lives. Estimated depreciation rates of tangible fixed assets are as follows:

	Depreciation Rate
Buildings	2%
Vehicles	20%
Other Tangible Assets	6.66% - 33.33%

There is no change in accounting estimations that has material effect in the current period or that is expected to have effect in the subsequent periods.

2.12 Intangible Assets

Intangible assets acquired are reported at cost less accumulated depreciation and accumulated impairment losses.

Amortization is charged on a straight-line basis over their estimated useful life which is 33.33%. The estimated useful life and amortization method are reviewed at the date of each annual reporting period, with the effect of changes in the estimate being accounted for on a prospective basis.

Intangible assets are assessed for impairment whenever there is an indication that the intangible asset may be impaired. There is no impairment recorded related to intangible assets at the accompanying consolidated financial statements.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the income statement when the asset is derecognized.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.13 Impairment of non-financial assets

Assets that have an indefinite useful life, for example goodwill, are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

2.14 Investment property

Investment property, which is property, held to earn rentals and/or for capital appreciation is carried at cost less accumulated depreciation and any accumulated impairment losses. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met; and excludes the costs of day to day servicing of an investment property. Depreciation is provided on investment property on a straight line basis. The depreciation period for investment property is 50 years.

2.15 Investments and Other Financial Assets

The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss ("FVTPL"); loans and receivables; held-to-maturity investments and available-for-sale financial assets("AFS"). When financial assets are recognized initially, they are measured at fair value (net of transaction costs except for those financial assets classified as at fair value through profit and loss which are initially measured at fair value). The Group determines the classification of its financial assets at initial recognition.

<u>Effective interest method</u>

The effective interest method is a method of calculating the amortized cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Income is recognized on an effective interest basis for debt instruments other than those financial assets designated as at FVTPL.

a) Financial Assets at Fair Value Through Profit or Loss

Financial assets at fair value through profit or loss are financial assets held-for-trading. Trading securities are securities, which were either acquired for generating a profit from short term fluctuations in price or dealer's margin, or are securities included in a portfolio in which a pattern of short term profit taking exist. Derivatives are also categorized as held-for-trading unless they are designated as effective hedging instruments. Gains or losses on investments held-for-trading are recognized in income.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.16 Investments and Other Financial Assets (continued)

b) Held-to-Maturity Investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity where management has both the intent and the ability to hold to maturity are classified as held-to-maturity. The Group follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgments. In making this judgment, the Group evaluates its intention and ability to hold such investments to maturity. If the Group fails to keep these investments to maturity other than for the specific circumstances - for example selling an insignificant amount close to maturity - it will be required to classify the entire class as available-for-sale. The investments would therefore be measured at fair value; not amortized cost. There has been no tainting in the held-to-maturity portfolio during 2017 or 2016.

Held-to-maturity investments are subsequently measured at amortized cost using the effective interest method, less any impairment in value. Amortized cost is calculated by taking into account all fees 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. For investments carried at amortized cost, gains and losses are recognized in income when the investments are derecognized or impaired, as well as through the amortization process.

Interest earned whilst holding held to maturity securities is reported as interest income.

When financial assets are transferred to held-to-maturity category from available-for-sale portfolio, as a result of a change in intention, the fair value carrying amount of the related financial assets becomes the new amortized cost. Any previous gain or losses on those assets that have been recognized in equity are amortized over the remaining life of the held-to-maturity investments using the effective interest method.

c) Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. Such assets are carried at amortized cost using the effective interest method less any impairment in value. Gains and losses are recognized in income when the loans and receivables are derecognized or impaired, as well as through the amortization process. Interest earned on such loans and receivables is reported as interest income.

d) Available-for-Sale Financial Assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition, available-for-sale financial assets are measured at fair value. Gains and losses arising from changes in fair value are recognized in other comprehensive income and accumulated in the investments revaluation reserve with the exception of impairment losses, interest calculated using the effective interest method, and foreign exchange gains and losses on monetary assets, which are recognized in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.

Dividends on available-for-sale equity instruments are recognized in profit or loss when the Group’s right to receive payments is established. The fair value of AFS monetary assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the balance sheet date. The change in fair value attributable to translation differences that result from a change in amortized cost of the asset is recognized in profit or loss, and other changes are recognized in other comprehensive income.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.17 Investments and Other Financial Assets (continued)

d) Available-for-Sale Financial Assets (continued)

For investments that are traded in an active market, fair value is determined by reference to stock exchange or current market bid prices, at the close of business on the balance sheet date. For investments where there is no market price or market price is not indicative of the fair value of the instrument, fair value is determined by reference to the current market value of another instrument which is substantially the same, by recent arm's length transactions, by discounted cash flow analysis or through other valuation techniques commonly used.

e) Repurchase and Resale Transactions

The Group enters into sales of securities under agreements to repurchase such securities at a fixed price at a fixed future date. Such securities, which have been sold subject to a repurchase agreement (‘repos’), are recognized in the balance sheet and are measured in accordance with the accounting policy of the security portfolio which they are part of. The counterparty liability for amounts received under these agreements is included in obligations under repurchase agreements. The difference between sale and repurchase price is treated as interest expense and accrued over the life of the repurchase agreements using the effective interest method.

2.18 Offsetting Financial Instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously.

2.19 Impairment of Financial Assets

a) Assets carried at Amortized Cost

In determining whether an impairment loss should be recorded in the income statement, the Group makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated amounts recoverable from a portfolio of loans and individual loans. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group about the following loss events:

(a) significant financial difficulty of the issuer or obligor;
(b) a breach of contract, such as a default or delinquency in interest or principal payments by more than 90 days;
(c) the Group granting to the borrower, for economic or legal reasons relating to the borrower’s financial difficulty, a concession that the lender would not otherwise consider;
(d) it becoming probable that the borrower will enter bankruptcy or other financial reorganization;
(e) the disappearance of an active market for that financial asset because of financial difficulties; or
(f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
    i. adverse changes in the payment status of borrowers; or
    ii. national or local economic conditions that correlate with defaults on the assets in the group.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.19 Impairment of Financial Assets (continued)

a) Assets carried at Amortized Cost (continued)

All loans with principal and/or interest overdue for more than 90 days are considered as impaired and individually assessed.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortized cost has been incurred, the amount of the loss is measured based on the difference between the asset's carrying amount and the estimated recoverable amount, determined by the net present value of the expected future cash flows discounted at the loan's original effective interest rate. The estimated recoverable amount of a collateralized financial asset is measured based on the amount that is expected to be realized from foreclosure less costs for obtaining and selling the collateral, whether or not the foreclosure is probable. The carrying amount of the asset is reduced through the use of an allowance account. The amount of the loss is recognized in the income statement.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e., on the basis of the Group's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for 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.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with credit risk characteristics similar to those in the Group. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

A write off is made when all or part of a loan is deemed uncollectible or in the case of debt forgiveness. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Write offs are charged against previously established allowances and reduce the principal amount of a loan. Subsequent recoveries of amounts previously written off are included in income.

b) Assets Carried at Cost

If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of its recoverable amount.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.19 Impairment of Financial Assets (continued)

c) Assets carried at Fair Value

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. Available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in profit or loss, is transferred from equity to the income statement. Impairment losses recognized in the income statement on equity instruments are not reversed through the income statement. Reversals of impairment losses on debt instruments are reversed through profit or loss; if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in profit or loss.

2.20 Cash and Cash Equivalents

For the purposes of the consolidated cash flows statement, cash and cash equivalents comprise cash, deposits with banks and other financial institutions and other money market placements with an original maturity of three months or less.

2.21 Derecognition of Financial Assets

The Group derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

2.22 Borrowings

All borrowings are initially recognized at the fair value of consideration received less directly attributable transaction costs. After initial recognition interest-bearing borrowings are subsequently measured at amortized cost using the effective interest method. Gains or losses are recognized in the income statement when the liabilities are derecognized as well as through the amortization process.

2.23 Derivative Financial Instruments

The Group enters into transactions with derivative instruments including currency swaps and forwards in the foreign exchange. Most of these derivative transactions are considered as effective economic hedges under the Group's risk management policies; however since they do not qualify for hedge accounting under the specific provisions of IAS 39, they are treated as derivatives held-for-trading. Derivative financial instruments are initially recognized at fair value on the date a derivative contract is entered into and are subsequently remeasured at fair value at the end of each reporting period. The resulting gains or losses recognized in profit or loss immediately, unless derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.23 Derivative Financial Instruments (continued)

In the absence of forward foreign currency market rates and reliable forward rate estimations in a volatile market, values of foreign currency swap transactions are determined by comparing the period end foreign exchange rates with the forward rates discounted to the balance sheet date. The resulting gain or loss is reflected to the statement of income.

2.24 Employee Benefits – Defined Benefit Plans

Termination and Retirement Benefits:

Under Turkish legislation and union agreements, lump sum payments are made to all employees who retire or whose employment is terminated without due cause. Such payments are based on number of years' service and final salary at the date of retirement or leaving.

International Accounting Standard No. 19 (revised) "Employee Benefits" ("IAS 19") has been applied in the accompanying financial statements. Future retirement payments are discounted to their present value at the balance sheet date at an interest rate determined as net of an expected inflation rate and an appropriate discount rate. This standard also allows the employee benefit liability to be reduced by anticipated forfeitures by eligible employees of their benefit. The retirement benefit obligation recognized in the statement of financial position represents value of the defined benefit obligation.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions were directly charged to statement of income in prior periods. As per revised IAS 19, actuarial gains/losses are recognized under shareholders' equity starting from 1 January 2013.

2.25 Provisions

Provisions are recognized when the Group has a present obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

2.26 Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessor

Amounts due from lessees under finance leases are recognized as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases.

Rental income from operating leases is recognized 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 recognized on a straight-line basis over the lease term.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.27 Interest Income and Expense Recognition

Interest Income and Expense

Interest income and expense are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, throughout the period to the next reprising date. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment) but does not consider future credit losses. The calculation includes all fees 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.

Fee and Commission Income

Fee and commission income and expenses that are integral to the effective interest rates on a financial asset or liability are included in the measurement of the effective interest rate. All other fee and commission income and expenses are recorded as income or expense on the date of collection or payment.

Net Trading Income

Net trading income includes gains and losses arising from disposals of financial assets at fair value through profit or loss, available for sale, and from trading derivatives.

Dividend Income

Dividend income is recognized in the statement of income when the right to receive payment is established.

2.28 Income Tax

Turkish tax legislation does not permit a parent company and its subsidiary to file a consolidated tax return. Therefore, provisions for taxes, as reflected in the accompanying consolidated financial statements, have been calculated on a separate-entity basis.

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

Current tax

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.28 Income Tax (continued)

Current tax (continued)

The corporate tax rate of 20% implementation on the Corporate Tax Law No. 5520 was taken into effect on 1 January 2006 after being published in the Official Gazette dated 21 June 2006 numbered 26205 , will be applied as 22% for corporation earnings for three years from 1 January 2018 with the regulation dated 28 November 2017 numbered 7061. Furthermore, Cabinet is made authorized to decrease this ratio to 20% from 22%. The bank applies new regulations to its current and deferred tax responsibilities. The corporate tax rate is calculated on the total income of the Bank after adjusting for certain disallowable expenses, exempt income (like affiliate gains) and other allowances. If there is no dividend distribution, no further tax charges are made.

Deferred tax

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

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

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

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

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.28 Income Tax (continued)

Current and deferred tax for the period

Current and deferred tax are recognized as an expense or income in profit or loss, except when they relate to items that are recognized outside profit or loss (whether in other comprehensive income or directly in equity), in which case the tax is also recognized outside profit or loss, or where they arise from the initial accounting for a business combination. In the case of a business combination, the tax effect is taken into account in calculating goodwill or determining the excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost.

2.29 Fiduciary Assets

Assets held by the Group in a fiduciary, agency or custodian capacity for its customers are not included in the balance sheet, since such items are not treated as assets of the Group. The Bank has no fiduciary assets.

2.30 Segment Reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products and services within a particular economic environment that are subject to risks and return that are different from those of segments operating in other economic environment.

2.31 New standards and interpretations not yet adopted

Standards, interpretations and amendments to existing standards that are issued but not yet effective up to the date of issuance of the consolidated financial statements are as follows. The Group will make the necessary changes if not indicated otherwise, which will be affecting the consolidated financial statements and disclosures, after the new standards and interpretations become in effect.

IFRS 9 Financial Instruments

IFRS 9, published in July 2014, replaces the existing guidance in IAS 39 "Financial Instruments: Recognition and Measurement". It also carries forward the guidance on recognition, classification, measurement and derecogniton of financial instruments from IAS 39 to IFRS 9. The last version of IFRS 9 includes a new expected credit loss model for calculating impairment on financial assets, and new general hedge accounting requirements and also includes guidance issued in previous versions of IFRS 9. IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. The Group is in the process of assessing the impact of the new standard on consolidated financial position or performance of the Group.

IFRS 15 Revenue from Contracts with customers

The new standard replaces existing IFRS and US GAAP guidance and introduces a new control-based revenue recognition model for contracts with customers. 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. IFRS 15 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. The Group is in the process of assessing the impact of the new standard on consolidated financial position or performance of the Group.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.31 New standards and interpretations not yet adopted (continued)

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, SIC 15 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 Group is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 16.

IFRIC 22 – Foreign Currency Transactions and Advance Consideration

The amendments clarify the accounting for transactions that include the receipt or payment of advance consideration in a foreign currency. The Interpretation covers foreign currency transactions when an entity recognizes a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration before the entity recognizes the related asset, expense or income. The date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. The amendment is effective for annual reporting periods beginning on or after 1 January 2018 with earlier application is permitted. The Group is in the process of assessing the impact of the amendment on consolidated financial position or performance of the Group.

Amendments to IAS 12 Income Taxes– Recognition of Deferred Tax Assets for Unrealised Losses

The amendments clarify that the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset. The amendments are effective for annual periods beginning on or after 1 January 2017. The Group is in the process of assessing the impact of the amendment on consolidated financial position or performance of the Group.

Amendments to IFRS 2 – Classification and Measurement of Share-based Payment Transactions

IFRS 2 Share-Based Payment has been amended by IASB to improving consistency and resolve some long-standing ambiguities in share-based payment accounting. The amendments cover three accounting areas: i) measurement of cash-settled share-based payments, ii) classification of share-based payments settled net of tax withholdings; and iii) accounting for modification of a share-based payment from cash-settled to equity-settled. Also, same approach has been adopted for the measurement of cash-settled share-based payments as equity-settled share-based payments. If certain conditions are met, share-based payments settled net of tax withholdings are accounted for as equity-settled share-based payments. The amendments are effective for periods beginning on or after 1 January 2018, with earlier application permitted. The Group is in the process of assessing the impact of the amendment on consolidated financial position or performance of the Group.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.31 New standards and interpretations not yet adopted (continued)

Annual Improvements to IFRSs 2014-2016 Cycle

IFRS 1 "First Time Adoption of International Financial Reporting Standards"

IFRS 1 is amended to clarify that the deletion of short-term exemptions for first-time adopters within the context of 'Annual Improvements to IFRSs 2012-2014 Cycle' related to disclosures for financial instruments, employee benefits and consolidation of investment entities.

IFRS 12 "Disclosure of Interests in Other Entities"

The amendments clarify that the entity is not required to disclose summarized financial information for that subsidiary, joint venture or associate under the requirements of IFRS 12, when an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) is classified (or included in a disposal group that is classified) as held for sale in accordance with IFRS 5.

IAS 28 "Investments in Associates and Joint Ventures"

The amendment enable when an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that investment at fair value through profit or loss in accordance with IFRS 9.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

3. SEGMENT INFORMATION

Business segments

The Group is organized into three main business segments, Treasury, Investment Banking and Tourism, which are organized and managed separately according to the nature of the products and services provided.

The segment results for the year ended 31 December 2017 are as follows:

	Treasury	Investment Banking	Undistributed	Eliminations	Group
Interest income	115,306	259,665	38	-	375,009
Interest expense	(1,819)	(93,768)	-	-	(95,587)
Net interest income	**113,487**	**165,897**	**38**	**-**	**279,422**
Fees and commissions income	-	13,035	293	-	13,328
Fees and commissions expenses	(610)	-	-		(610)
Foreign exchange gains/(losses)	4	(3,643)	-	-	(3,639)
Gains/(losses) on securities	(3)	-	-	-	(3)
Other operating income	-	3,403	123	-	3,526
Other operating expenses	-	-	(90,902)		(90,902)
(Provisions for) / impairment of loans and other assets	-	(14,019)	-	409	(13,610)
Income/(loss) from associates	-	12,869	-	-	12,869
Profit / (loss) before income tax	**112,878**	**177,542**	**(90,486)**	**409**	**200,381**
Income tax	-	-	(28,285)	-	(28,285)
Net profit/(loss)	**112,878**	**177,542**	**(118,771)**	**409**	**172,096**

The segment assets and liabilities at 31 December 2017 are as follows:

	Treasury	Investment Banking	Undistributed	Eliminations	Group
Assets and Liabilities					
Segment assets	1,910,518	6,936,830	80,731	(1,592)	8,926,487
Investment in associates	-	51,846	-	(3,201)	48,645
Total assets	**1,910,518**	**6,988,676**	**80,731**	**(4,793)**	**8,975,132**
Segment liabilities	130	7,584,279	1,395,776	(4,793)	8,975,132
Total liabilities and equity	**130**	**7,584,279**	**1,395,776**	**(4,793)**	**8,975,132**

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

3. SEGMENT INFORMATION (continued)

Business segments (continued)

The segment results for the year ended 31 December 2016 are as follows:

	Treasury	Investment Banking	Undistributed	Eliminations	Group
Interest income	47,971	171,062	858	-	219,891
Interest expense	(42)	(53,994)	-	-	(54,036)
Net interest income	**47,929**	**117,068**	**858**	**-**	**165,855**
Fees and commissions income	-	18,968	1,033	-	20,001
Fees and commissions expenses	(405)	-	-	-	(405)
Foreign exchange gains/(losses)	16	5,309	-	-	5,325
Gains/(losses) on securities	9	-	-	-	9
Other operating income	-	8,538	881	-	9,419
Other operating expenses	-	-	(84,005)	(15)	(84,020)
(Provisions for) / impairment of loans and other assets	-	(17,751)	-	-	(17,751)
Income/(loss) from associates	-	5,116	-	-	5,116
Profit / (loss) before income tax	**47,549**	**137,246**	**(81,233)**	**(15)**	**103,549**
Income tax	-	-	(21,645)	-	(21.645)
Net profit/(loss)	**47,549**	**137,461**	**(102,878)**	**(15)**	**81,904**

The segment assets and liabilities at 31 December 2016 are as follows:

	Treasury	Investment Banking	Undistributed	Eliminations	Group
Assets and Liabilities					
Segment assets	1,481,699	5,425,582	77,628	(1,887)	6,983,022
Investment in associates	-	31,781	-	4,290	36,071
Total assets	**1,481,699**	**5,457,363**	**77,628**	**2,403**	**7,019,093**
Segment liabilities	351	5,800,507	1,215,832	2,403	7,019,093
Total liabilities and equity	**351**	**5,800,507**	**1,215,832**	**2,403**	**7,019,093**

Geographical segments

The Group’s operations are mainly conducted in Turkey. Accordingly, geographical segment information is not presented.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

4. CASH AND CASH EQUIVALENTS

	31 December 2017	31 December 2016
Cash on hand	**84**	**50**
Demand deposits - Turkish Lira	63,613	345,789
Demand deposits - Foreign Currency	9,966	11,627
Time deposits	1,261,611	908,010
Deposits with banks and other financial institutions	**1,335,190**	**1,265,426**
Cash and cash equivalents	**1,335,274**	**1,265,476**
Balances with Central Bank	**626**	**1,020**
Money market placements	**326,024**	**10,505**
Less: Interest accruals	(4,317)	(1,349)
Cash and cash equivalents in the statement of cash flows	**1,657,607**	**1,275,652**

The effective interest rates on deposits and placements are as follows:

	31 December 2017		31 December 2016	
	Effective interest rate		Effective interest rate	
	Turkish Lira	Foreign Currency	Turkish Lira	Foreign Currency
Deposits with banks and other financial institutions (*)	13.44%	1.14%	9.21%	0.62%
Money Market Placements	13.79%	-	8.49%	-

(*) Interest rates calculated from weighted average of placements as of 31 December 2017 and 2016.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

5. INVESTMENTS IN FINANCIAL INSTRUMENTS

Financial assets at fair value through profit and loss:

Investment Securities:

	31 December 2017	31 December 2016
	Amount	**Amount**
Available- for-sale securities at fair value		
Turkish Government bonds issued by the Turkish Government	158,949	106,597
Debt securities issued by corporations	90,355	78,755
Available-for-sale securities at cost		
Equity instruments –unlisted at cost (*)	8,037	8,048
Investment funds		
Total available for sale securities	**257,341**	**193,400**

	31 December 2017	31 December 2016
	Amount	**Amount**
Held to maturity securities at amortized cost		
Turkish Government bonds (quoted)	--	20,415
Total held-to-maturity securities	**--**	**20,415**

(*) Unlisted equity securities classified as available-for-sale securities represent the Group's equity holdings in the companies, shares of which are not publicly traded. Consequently, they are reflected at cost less reserves for impairment, as a reliable estimate of their fair values could not be made.

Movement of held-to-maturity investments

	Current Period (31.12.2017)	Prior Period (31.12.2016) (*)
Balance at the beginning of the period	20,415	20,532
Foreign currency differences on monetary assets	-	-
Purchases during the year (*)	-	1,301
Disposals through sales and redemptions (*)	(20,415)	(1,418)
Provision for impairment (-)	-	-
Balance at the end of the period	**-**	**20,415**

(*) As of 31 December 2016, TRY 1.296 of purchases and TRY 1.381 of disposals include discount differences.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

5. INVESTMENTS IN FINANCIAL INSTRUMENTS (continued)

Government bonds and treasury bills pledged under repurchase agreements with customers included at available for sale securities amount to TRY 146 Thousand (31 December 2016: TRY 392). Related liability is equal to TRY 130 Thousand as of 31 December 2017 (31 December 2016: TRY 351 Thousand). As of 31 December 2017, government securities with carrying value amounting to TRY 42,706 Thousand (31 December 2016: TRY 15,260 Thousand) in available for sale securities portfolio are pledged to the Central Bank and the IMKB Takas ve Saklama Bankası Anonim Şirketi (Istanbul Stock Exchange Clearing and Custody Bank) for regulatory requirements and as a guarantee for stock exchange and money market operations.

6. LOANS AND ADVANCES

	31 December 2017	31 December 2016
Loans and advances to financial institutions		
Financial Institution Originated		
Agence Française de Développement Originated Loans	76,618	13,988
Council of Europe Development Bank Originated Loans	452,197	386,049
Total loans and advances to financial institutions	**528,815**	**400,037**
Loans and advances to customers	-	-
Financial Institution Originated		
KFW	92,541	75,435
Islamic Development Bank Originated Loans	1,347,598	512,715
European Investment Bank Originated Loans	2,869,370	2,042,707
Council of Europe Development Bank Originated Loans	-	5,563
World Bank Originated Loans	634,902	1,520,449
Treasury Loans	70,228	-
Development Bank of Japan	173,731	397,788
Bank Sourced		
Investment Loans	312,579	105,339
Personnel Loans	4,989	4,491
Restructured Loans	68,426	78,786
Other Bank Sourced Loans	775,139	206,680
Non-performing Loans	117,385	120,209
Total loans and advances to customers	**6,466,888**	**5,070,162**
Less: allowance for losses on loans and advances	(92,922)	(81,109)
Total loans and advances to customers, (net)	**6,373,966**	**4,989,053**

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

6. LOANS AND ADVANCES (continued)

Allowance for probable losses on loans and advances include portfolio reserve and specific reserve for loans amounting to TRY 67,969 and TRY 24,953,respectively (31 December 2016: TRY 56,385 and TRY 24,724, respectively). The portfolio reserve for impairment is provided based on past experience, management's assessment of current economic conditions, the quality and inherent risks in the credit portfolio of the Group.

Movements in the allowance for probable losses on loans and advances:

	31 December 2017	31 December 2016
At the beginning of the year	81,109	63,358
Provision for impairment	16,490	22,197
Recoveries	(4,677)	(4,446)
At the end of the year	**92,922**	**81,109**

7. INVESTMENT IN ASSOCIATES

Istanbul Venture Capital Initiative ("IVCI") is established in Luxembourg in 2007 as the first fund of funds and co-investment program of Turkey. The share and voting power of the Bank is 6.25% and 11.1%, respectively (31 December 2016: 6.25% and 11.1%). Capital commitment of IVCI is EUR 160 Million (full amount) and the Bank's capital commitment is EUR 10 Million (full amount). The Bank has made cumulative of EUR 7,467,500 capital payment as at balance sheet date.

Maksan Malatya Makina Sanayi A.Ş. is established in Malatya, Turkey in 1974 for manufacturing of transformers. The share and voting power of the Bank is 31.14% and 20% respectively (31 December, 2016: 31.14% and 20%).

Türk Suudi Holding A.Ş. is established in İstanbul, Turkey in order to operate in finance sector. By General Assembly held on 25 March 2008, liquidation process of the company was started and is on-going as at the balance sheet date. The share and voting power of the Bank is 24.69% and 10% respectively (31 December, 2016: 24.69% and 10%).

Financial information of the Group's associates is summarized below:

	31 December 2017	31 December 2016
Total assets	604,082	466,024
Total liabilities	(10,690)	(10,361)
Net Assets	**593,392**	**455,663**
Group's share of associates' net assets	**48,645**	**36,071**

The Group's share of associates' net assets includes net assets of Maksan Malatya Makina Sanayi A.Ş. amounting to TRY 5,014 Thousand (31 December 2016: TRY 4,802 Thousand), net assets of Türk Suudi Holding A.Ş. amounting to TRY 6,325 Thousand (31 December 2016: TRY 5,300 Thousand) and net assets of IVCI amounting to TRY 37,305 Thousand (31 December 2016: TRY 25,969 Thousand).

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

7. INVESTMENT IN ASSOCIATES (cont'd)

	31 December 2017	31 December 2016
Revenue	59,361	91,203
Profit/(loss) for the year	34,670	57,980
Group's share of associates' income / (loss)	**12,869**	**5,116**

8. PREMISES AND EQUIPMENT

Current Period (31.12.2017)	**Real-Estates**	**Vehicles**	**Other**	**Total**
Cost				
Balance at the beginning of the period	119,750	130	11,266	131,146
Movements during the period				
-Additions	-	-	78	78
-Disposals (-)	-	-	(472)	(472)
- Recoveries from impairment	-	-	-	-
Balance at the end of the period	**119,750**	**130**	**10,872**	**130,752**
Accumulated Depreciation				
Balance at the beginning of the period	81,972	116	6,833	88,921
Movements during the period				
-Depreciation charge	2,442	8	1,818	4,268
-Disposals (-)	-	-	(470)	(470)
Balance at the end of the period	**84,414**	**124**	**8,181**	**92,719**
Net book value at the end of the period	**35,336**	**6**	**2,691**	**38,033**

Period Period (31.12.2016)	**Real-Estates**	**Vehicles**	**Other**	**Total**
Cost				
Balance at the beginning of the period	111,953	130	9,679	121,762
Movements during the period				
-Additions	-	-	1,860	1,860
-Disposals (-)	-	-	(273)	(273)
- Recoveries from impairment (*)	7,797	-	-	7,797
Balance at the end of the period	**119,750**	**130**	**11,266**	**131,146**
Accumulated Depreciation				
Balance at the beginning of the period	79,531	109	5,414	85,054
Movements during the period				
-Depreciation charge	2,441	7	1,686	4,134
-Disposals (-)	-	-	(267)	(267)
Balance at the end of the period	**81,972**	**116**	**6,833**	**88,921**
Net book value at the end of the period	**37,778**	**14**	**4,433**	**42,225**

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

9. INVESTMENT PROPERTIES

	Current Period 31 December 2017	**Prior Period 31 December 2016**
Cost		
Balance at the beginning of the year	18,333	18,333
Movements during the year	-	-
-Additions	-	-
-Classified from premises and equipment	-	-
Balance at the end of the year	**18,333**	**18,333**
Accumulated Depreciation		
Balance at the beginning of the year	9,421	8,688
Movements during the year		
-Depreciation charge	44	366
-Classified from premises and equipment	-	-
Balance at the end of the year	**9,465**	**9,054**
Net book value at the end of the year	**8,868**	**9,279**

Investment properties are accounted for at cost less accumulated depreciation and accumulated impairment, if any. Fair value of the Group's investment properties is TRY 20,886 based on valuations made as at 31 December 2017 and competent persons' report dated 16 June 2015. The fair value of the Group's investment properties has been arrived at on the basis of valuations carried out by independent appraisal who has a valuation license obtained from the Capital Markets Board of Turkey. The fair values are determined using similar transactions method. The property rental income earned by the Group from its investment properties amounts to TRY 570 (31 December 2016: TRY 507).

10. INTANGIBLE ASSETS

	Current Period 31 December 2017	**Prior Period 31 December 2016**
Cost		
Balance at the beginning of the year	5,241	3,958
Movements during the year	-	-
-Additions	314	1,283
-Classified from premises and equipment	-	-
Balance at the end of the year	**5,555**	**5,241**
Accumulated Depreciation		
Balance at the beginning of the year	3,710	2,795
Movements during the year	-	
-Depreciation charge	797	915
-Classified from premises and equipment	-	-
Balance at the end of the year	**4,507**	**3,710**
Net book value at the end of the year	**1,048**	**1,531**

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

11. OTHER ASSETS

	31 December 2017	31 December 2016
Non-current assets to be disposed	27,729	30,419
Sundry debtors	9,884	9,601
Prepaid fees and commissions	5,420	4,819
Other	1,654	1,627
Total	**44,687**	**46,466**

12. FUNDS BORROWED

	31 December 2017	31 December 2016
Borrowings	7,315,905	5,785,105
Funds	268,615	15,404
Total	**7,584,520**	**5,800,509**

31 December 2017	Amount	Weighted Average Interest Rate	Maturity
USD denominated borrowings	2,972,256	2.05%	2018-2041
EUR denominated borrowings	4,342,968	0.52%	2018-2036
TL Other borrowings	681	12.4%	2018
Total	**7,315,905**		

31 December 2016	Amount	Weighted Average Interest Rate	Maturity
USD denominated borrowings	2,465,697	2.11%	2017- 2037
EUR denominated borrowings	3,319,408	0.50%	2017- 2037
Total	**5,785,105**		

The amounts of funds of the Group as of 31 December 2017 and 2016 are as follows:

	31 December 2017	31 December 2016
Incentive fund	252,812	-
Environment fund	5,146	5,159
Other	10,657	10,245
Total	**268,615**	**15,404**

Funds borrowed include other funds obtained that are granted as loans as specified in the agreements signed between the Bank, and the Ministries or the institutions that the funds belong to. As of 31 December 2017, incentive fund amounting to TRY 252,812 was obtained from Undersecretariat of Treasury of the Turkish Republic.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

12. FUNDS BORROWED (continued)

	31 December 2017	**31 December 2016**
Borrowings with no maturity	252,682	-
Short term borrowings	22,027	15,404
Short term part of long term borrowings	542,521	366,131
Long term borrowings	6,767,290	5,418,974
Total	**7,584,520**	**5,800,509**

Repayment plan of borrowings is as follows:

	31 December 2017	**31 December 2016**
2017	-	381,536
2018 and thereafter	564,548	5,418,973
2019 and thereafter	6,767,290	-
Total	**7,331,838**	**5,800,509**

Funds borrowed are unsecured. Floating rate borrowings bear interest at rates fixed in advance for periods of 6 to 12 months.

Most of the loans from international finance institutions are from World Bank, European Investment Bank, European Commission Development Bank, Islamic Development Bank, French Development Agency and Japan International Corporation Bank. Domestic loans are from Eximbank, Arab Turkish Bank and Turkish Treasury.

As the Bank is not authorized to accept deposits, liabilities are composed of funds obtained from domestic and international financial institutions, medium and long term loans.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

13. OTHER LIABILITIES AND PROVISIONS

	31 December 2017	31 December 2016
Other liabilities		
Payables to public enterprises	3,926	4,027
Unearned revenue	174	315
Other transitory accounts	675	2,516
Import transfer orders	-	-
Taxes and dues payable	-	1,261
Subscription fee	3,628	2,243
Blocked currency	11,752	4,218
Lawsuit expenses	1,157	335
Other (*)	3,373	352,514
	24,685	**367,429**
Provisions		
Employee benefits provision	36,128	34,791
	36,128	**34,791**
Total	**60,813**	**402,220**

(*)In the meeting of the General Assembly it has been resolved that, paid-in capital of the Bank will be increased from TRY 160.000 thousand to TRY 500.000 thousand by adding TRY 340.000 thousand. TRY 340.000 thousand transferred from the capital increase account of Ziraat Yenişehir Branch to the Bank on 26 December 2016, issuance of shares were registered on the trade registry on 17 February 2017 and published in the Official Gazette dated 22 February 2017 and 1 March 2017.

Employee Termination Benefits

In accordance with existing social legislation, the Bank and its subsidiary incorporated in Turkey are required to make lump-sum payments to employees whose employment is terminated due to retirement or for reasons other than resignation or misconduct. Such payments are calculated on the basis of 30 days' pay (limited to a maximum of full TRY 5,001.763 and full TRY 4,4,426.16 at 31 December 2017 and 2016, respectively) per year of employment at the rate of pay applicable at the date of retirement or termination. In the financial statements as of 31 December 2017 and 2016, the Group reflected a liability calculated using the Projected Unit Credit Method and based upon factors derived using their experience of personnel terminating their services and being eligible to receive retirement pay and discounted by using the current market yield on government bonds at the balance sheet date.
Movements in the present value of the defined benefit were as follows:

	31 December 2017	31 December 2016
Opening defined benefit obligation	34,550	32,472
Changes in current period	5,332	4,666
Actuarial profit/loss	(168)	(1,048)
Benefits paid	(3,837)	(1,540)
Closing defined benefit obligation, recognized in the balance sheet	**35,877**	**34,550**
Provision for unused vacation	251	241
Total	**36,128**	**34,791**

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

14. INCOME TAXES

Corporate Tax

The Group is subject to corporate taxes. Provision is made in the accompanying financial statements for the estimated charge based on the Group's results for the period.

While the corporate tax rate was at the rate of 20% since 1 January 2016, for all companies, such rate has been set as 22% for the tax bases of the years 2018, 2019, and 2020 based on the legislation of the Amendment on Certain Tax Laws and Other Laws no. 7061. Furthermore, the Council of Ministers has been authorized to reduce the rate of 22% down to 20%.

Corporate tax losses can be carried forward for a maximum period of five years following the year in which the losses were incurred. The tax authorities can inspect tax returns and the related accounting records for a retrospective maximum period of five years. Corporate tax returns are required to be filed by the twenty-fifth day of the fourth month following the year-end reporting date and taxes must be paid in one instalment by the end of the fourth month.

Losses are allowed to be carried 5 years maximum to be deducted from the taxable profits of the following years. However, losses incurred cannot be deducted from the profits incurred in the prior years retrospectively.

In Turkey, there is no procedure for a final and definitive agreement on tax assessments. Companies file their tax returns between April 1 and April 25 following the close of the accounting year to which they relate. Tax authorities may, however, examine such returns and the underlying accounting records and may revise assessments within five years.

Income Withholding Tax

In addition to corporate taxes, companies should also calculate income withholding taxes on any dividends distributed, except for companies receiving dividends who are resident companies in Turkey and Turkish branches of foreign companies. The rate of income withholding tax is 15%. Undistributed dividends incorporated in share capital are not subject to income withholding taxes.

As of 31 December 2017 and 2016 advance income taxes are netted off with the current income tax liability as stated below:

	31 December 2017	**31 December 2016**
Income tax liability	36,120	22,433
Advance income taxes	(27,057)	(14,890)
	9,063	**7,543**

Major components of income tax expense for the years ended 31 December 2017 and 2016 are:

	31 December 2017	**31 December 2016**
Current income tax expense	36,120	22,433
Deferred income tax expense / (income)	(7,835)	(788)
Income tax expense reported in the consolidated income statement	**28,285**	**21,645**

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

14. INCOME TAXES (continued)

Reconciliation between tax expense and the accounting profit multiplied by the statutory income tax rate of the parent for the year ended 31 December 2017 and 2016 are as follows:

	31 December 2017	31 December 2016
Profit before income tax	200,381	103,549
At Turkish statutory income tax rate of 20% (2016: 20%)	40,076	20,710
Disallowed expenses	7,738	13
Income exempt from taxation	(4,545)	(52)
Other adjustments	(14,984)	974
Income tax	**28,285**	**21,645**

Deferred income tax

Deferred income tax as at 31 December 2017 and 2016 relates to the following:

	31 December 2017	31 December 2016
Deferred Tax Assets		
From Interest Rediscounts	63	7
From Severence Payments	7,226	6,958
Other Non-Financial Treasury Bills and Government Bonds	363	-
Uncollectable Loans	4,587	1,362
Other	1,217	118
Total Deferred Tax Assets	**13,456**	**8,445**
Deferred Tax Liabilities		
From Depreciations	(758)	-
From Interest Rediscounts	(24)	-
Reversal of specific loan provision	-	(4,454)
Other	(869)	(7)
Total Deferred Tax Liabilities	**(1,651)**	**(4,461)**
Net Deferred Tax Assets	**11,805**	**3,984**

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

14. INCOME TAXES (continued)

Movement of net deferred tax asset / (liability) can be presented as follows:

	31 December 2017	**31 December 2016**
Balance at January 1	3,982	3,382
Deferred income tax credit (charge) recognized in equity	(12)	(188)
Deferred income tax credit (charge) recognized in income statement	7,835	788
Balance at period-end	**11,805**	**3,982**

15. SHARE CAPITAL

The capital ceiling of the Bank which is subject to registered capital system is TRY 2,500,000 Thousand. The authorized paid-in share capital of the Bank amounted to TRY 500,000 Thousand as of 31 December 2017 (31 December 2016: 160,000 Thousand). The Bank's capital consist of 50 Billion shares with par value of full TRY 0,01 each. In the current period, number of shares issued are increased as a result of capital increase have been made by the management which is fully paid in cash amounting to TRY 340,000 thousand.

	Share (%)	**31 December 2017**	**31 December 2016**
Paid capital per statutory records			
- Undersecretariat of Treasury of the Turkish Republic	99.08	495,408	158,530
- Other Shareholders	0.92	4,592	1,470
		500,000	160,000
Indexation Effect		1,290,923	1,290,923
Indexed Share Capital		1,790,923	1,450,923

16. DIVIDENDS PAID AND PROPOSED

No dividend payment has been made in this period.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

17. EARNINGS PER SHARE

Basic earnings per share (EPS) are calculated by dividing the net profit for the year attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year.

In Turkey, companies can increase their share capital by making a pro rata distribution of shares ("Bonus Shares") to existing shareholders without consideration for amounts resolved to be transferred to share capital from profit reserves such as retained earnings and revaluation surplus. For the purpose of the EPS calculation such Bonus Share issues are regarded as stock dividends. Dividend payments, which are immediately reinvested in the shares of the Bank, are regarded similarly. Accordingly, the weighted average number of shares used in the EPS calculation is derived by giving retroactive effect to the issue of such shares. The Bank has not experienced this kind of a capital increase.

	Number of Shares Issued Attributable to					
	Opening	**Cash**	**Transfers from Retained Earnings**	**Reinvestment of Dividend Payments**	**Total**	**Closing**
2013 and before	16,000,000	-	-	-	-	16,000,000
2014	16,000,000	-	-	-	-	16,000,000
2015	16,000,000	-	-	-	-	16,000,000
2016	16,000,000	-	-	-	-	16,000,000
2017	16,000,000	34,000,000	-	-	-	50,000,000

There is no dilution of shares as of 31 December 2017 and 2016.

The following reflects the income (in full TRY) and share data used in the basic earnings per share computations:

	31 December 2017	**31 December 2016**
Net profit / (loss) attributable to ordinary shareholders for basic earnings per share	172,096,000	81,904,000
Weighted average number of ordinary shares for basic earnings per share	45,528,767,123	16,000,000,000
Basic earnings per 100 shares (Full TRY)	0.3780	0.5119

There have been no other transactions involving ordinary shares or potential ordinary shares as of the date of this report.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

18. RELATED PARTIES

A party is related to an entity if: the party controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries); has an interest in the entity that gives it significant influence over the entity or has joint control over the entity. For the purpose of these consolidated financial statements, unconsolidated subsidiaries, associates, shareholders are referred to as related parties. Related parties also include individuals that are principal owners, management and members of the Group's Board of Directors and their families and also post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

The immediate parent and ultimate controlling party of the Group is the Undersecretariat of Treasury of the Turkish Republic. Transactions between the Bank and its subsidiary, which is a related party of the Bank, have been eliminated on consolidation and are not disclosed in this note.

As of 31 December 2017, funds borrowed amounting to TRY 252,812 was obtained from Undersecretariat of Treasury of the Turkish Republic (31 December 2106: nil).

Transactions with key management personnel:

Key management personnel comprise of the Group's directors and key management executive officers.

As of 31 December 2017 and 2016 the Group's directors and executive officers have no outstanding personnel loans from the Bank.

In addition to their salary, the Group also provides non-cash benefits to directors.

Total compensation provided to key management personnel is:

	31 December 2017	**31 December 2016**
Salary	991	965
Dividend and fringe benefits	148	148
Total	**1,139**	**1,113**

19. INTEREST INCOME ON SECURITIES

	31 December 2017	**31 December 2016**
Available-for-sale financial assets	16,406	10,053
Held to maturity investments	15	1,919
Total	**16,421**	**11,972**

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

20. OTHER OPERATING INCOME

	31 December 2017	31 December 2016
Income from sale of properties	2,076	347
Reversal of other provisions	514	8,191
Other	936	881
Total	**3,526**	**9,419**

21. OTHER OPERATING EXPENSES

	31 December 2017	31 December 2016
Administrative expenses	15,020	12,306
Staff costs:		
Personnel expenses	60,022	56,909
Retirement pay provision	5,332	4,885
Depreciation and amortization expense	5,109	5,373
Other	5,419	4,547
Total	**90,902**	**84,020**

22. FEES AND COMMISSIONS INCOME AND EXPENSES

	31 December 2017	31 December 2016
Fees and commissions income		
Banking	13,328	20,001
Total	**13,328**	**20,001**
Fees and commissions expenses		
Banking	(610)	(405)
Total	**(610)**	**(405)**

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

23. COMMITMENTS AND CONTINGENCIES

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

	31 December 2017	31 December 2016
Letters of guarantee issued	37	38
Letters of credit	772	84,402
Total non-cash loans	**809**	**84,440**
Other commitments	11,393	10,484
Total	**12,202**	**94,924**

IVCI (A Luxemburg Investment Company Fund) ("Fund") is founded as a stock company having variable capital and subject to laws of Luxemburg. The Bank has committed to buy "Group A" shares equal to nominal value of EUR 10 million and to pay this amount at the date determined by Fund according to its investment plan. The Fund's initial capital commitment was EUR 150 Million and its capital was increased to EUR 160 Million with new participants in March 2009. The Bank's participation was approved by the Board of Directors of IVCI on 13 November 2007 and share purchase agreement was signed as of the same date. The Bank made payment of share capital amounting to EUR 7,155,000 constituting payments equal to EUR 300,000 on 7 November 2008, EUR 218,750 on 6 July 2009 and EUR 281,250 on 12 November 2010, EUR 167,500 on 15 July 2011, EUR 437,500 on 10 November 2011, EUR 500,000 on 15 February 2012, EUR 500,000 on 25 May 2012, EUR 250,000 on 10 August 2012, EUR 500,000 on 19 September 2012, EUR 500,000 on 18 January 2013, EUR 500,000 on 27 June 2013 and EUR 500,000 on 13 December 2013, EUR 500,000 on 1 August 2014, EUR 500,000 on 29 August 2014, EUR 500,000 on 4 May 2015, EUR 500,000 on 16 October 2015 and EUR 500,000 on 3 May 2016.
With reference to the above capital contributions, out of the Bank's total commitment of EUR 10 million, EUR 7,467,500 have been paid, EUR 2,532,500 is not yet paid as of the reporting date.

Transactions Made on Behalf and Account of Others and Fiduciary Transactions

The Bank has no fiduciary transactions.

Litigation

As 31 December 2017, there are 103 cases which are brought against the Bank. The risk amount is TRY 4.449. The Bank doesn't expect any obligation by results of the cases so there is no any provision on the financial tables for these cases

24. FINANCIAL RISK MANAGEMENT

Organization of the Risk Management Function

Risk management activities of the Bank are performed under the responsibility of Board of Directors and in accordance with "Regulation on Banks' Internal Systems" published in the Official Gazette numbered 28337 and dated 28 June 2012. Top management is responsible against Board of Directors for monitoring and management of risks. In addition, departments included in the Internal Systems, namely Internal Control Department, Risk Monitoring Department and Board of Inspection transact their responsibilities independently from the executive departments.

The general risk principles followed by the bank can be defined as including the following activities: specializing in activities in accordance with its mission, vision and its structure defined in its settlement law, taking definable, monitorable and/or manageable risks accordingly, avoiding risks other than the ones unavoidable due to the main activities. Within this scope, fundamental principle is taking risks which are defined and manageable. Additionally, current and future potential effects of the risks currently taken are measured to the extent possible by the risk measurement and reporting techniques and it is continued to be performed accordingly.

The Bank actively uses committees and risk budgeting in its decision and risk management processes. In the Bank, risk management is performed by Asset Liability Committee and Loan Investment Committee, Asset Liability Committee sets risk policies for liquid assets and foreign currency position of the Bank, whereas Loan Investment Committee sets the principals for credit risk.

24. FINANCIAL RISK MANAGEMENT (continued)

Organization of the Risk Management Function (continued)

Considering the best practices, the Bank executes measuring, monitoring activities, testing and scenario analysis confirming with the volume, character and complexity of transactions, within the legal regulations and limits of the authority, and provides reporting to top management.

Credit Risk

The Bank manages its credit risk by limiting its risk through involvement with highly credible banks and organizations. Credibility of the counterparties is analyzed by different methods depending on the type of credit. Detailed analyses are performed and loan limits are submitted to the approval of Board of Directors or Loan Investment Committee depending on the amount of the loan to be disbursed. The limits of counter parties are determined for the total loans of a single company; and there is no special limit set for the sectoral or concentration basis. If the counterpart is not credible, no new credit is extended or limit is decreased to risk level. Since the placements of the Bank are in the form of project financing, the amount of loan that can be disbursed to a firm is basically determined during project assessment stage and disbursements are made in a controlled manner through monitoring of expenditures.

Under the risk management, the Bank obtains adequate collateral for loans given and other receivables. Such collateral comprises of real estate and tangible assets mortgages, business company liens, foreign currency notes and other liquid assets, bank guarantee letters and surety ships of reals persons or companies.

The sectoral distribution of the loan customers is monitored and those distributions are taken into account during placement decisions and goals.

The Bank is not subject to the general loan restrictions defined by the 54th article of the Banking Law numbered 5411. However, the loan limits are determined mostly in parallel with the limitations set out in the 54th article of the Banking Law.

Credit risk is analyzed by different group of loans and guarantees received for those loans. Also, the credibility of the debtors of the Group is assessed periodically in accordance with the prevailing regulations on lending and provisioning.

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

With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards.

The Bank bears low credit risk due to its foreign banking transactions as its credit risk is mainly concentrated in Turkey.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

24. FINANCIAL RISK MANAGEMENT (continued)

Credit Risk (continued)

Sectoral breakdown of cash loans is as follows:

	Cash	
	31 December 2017	**31 December 2016**
Manufacturing	**5,207,147**	**4,149,205**
Production	1,191,100	969,109
Electric, gas and water	4,016,047	3,180,096
Services	**1,671,171**	**1,196,293**
Hotel, food and beverage services	1,023,392	726,105
Financial institutions	528,815	398,791
Education Services	49,795	22,075
Health and social services	60,782	49,322
Other	8,387	4,492
Total loans	**6,878,318**	**5,349,990**
Non-performing loans	117,385	120,209
Less: allowance for losses on loans and advances	(92,922)	(81,109)
Total	**6,902,781**	**5,389,090**

Maximum exposure to credit risk for the components of the financial statements:

Maximum Exposure	**31 December 2017**	**31 December 2016**
Deposits with banks and other financial institutions	1,335,274	1,265,426
Money market placements	326,024	10,505
Balances with the Central Bank	626	1,020
Financial assets available for sale	257,341	193,400
Loans and advances	6,902,781	5,389,990
Investments held to maturity	-	20,415
Total	**8,822,046**	**6,880,756**
Contingent liabilities	809	84,440
Commitments	11,393	10,484
Total	**12,202**	**94,924**
Total credit risk exposure	**8,834,248**	**6,975,680**

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

24. FINANCIAL RISK MANAGEMENT (continued)

Credit Risk (continued)

Credit quality per class of financial assets as of 31 December 2017 and 2016:

As of 31 December 2017	Neither past due nor impaired	Past due and individually impaired or past due but not impaired	Total
Deposits with banks and other financial institutions	1,335,274	-	1,335,274
Loans	6,878,318	24,463	6,902,781
Financial Assets Available for Sale	257,341	-	257,341
Investments Held to Maturity	-	-	-

As of 31 December 2016	Neither past due nor impaired	Past due and individually impaired or past due but not impaired	Total
Deposits with banks and other financial institutions	1,265,404	-	1,265,404
Loans	5,343,838	45,252	5,389,090
Financial Assets Available for Sale	185,363	-	185,363
Investments Held to Maturity	20,415	-	20,415

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

24. FINANCIAL RISK MANAGEMENT (continued)

Credit Risk (continued)

Aging analysis of past due but not impaired financial assets per classes of financial instruments:

As of 31 December 2017	**Less than 30 Days**	**Between 31 and 60 Days**	**Between 61 and 90 Days**	**Total**
Loans				
Corporate Loans	699	-	-	699
Specialized Loans	220	-	-	220
Total	**919**	**-**	**-**	**919**

As of 31 December 2016	**Less than 30 Days**	**Between 31 and 60 Days**	**Between 61 and 90 Days**	**Total**
Loans				
Corporate Loans	119	1,334	-	1,453
Specialized Loans	2,168	1,267	1,264	4,699
Total	**2,287**	**2,601**	**1,264**	**6,152**

The net value and type of the collaterals of closely monitored loans is as follows:

Collateral Type	**31 December 2017**	**31 December 2016**
Real estate mortgage (*)	93,137	65,442
Financial collaterals (Cash, securities pledge, etc,)	227,395	214,623
Total	**320,532**	**280,065**

(*) Amount of collateral is stated at the lower of appraisal value or mortgage value. When the collateral value exceeds the credit risk loan balance, credit risk loan balance is presented.

The net value and type of the collaterals of non-performing loans is as follows:

Collateral Type	**31 December 2017**	**31 December 2016**
Real estate mortgage (*)	99,155	102,046
Other (**)	16,931	16,916
Total	**116,086**	**118,962**

(*) Amount of collateral is stated at the lower of appraisal value or mortgage value, When the collateral value exceeds the credit risk loan balance, credit risk loan balance is presented.

(**) As collateral, real estate mortgages have been obtained for loans.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

24. FINANCIAL RISK MANAGEMENT (continued)

Liquidity Risk

In the Bank, liquidity risk management is performed through proforma cash flows. These cash flows are prepared using forecasted data considering the maturity structure of assets and liabilities. The proforma cash flows includes information required to determine liquidity needs (if any) that would arise in the coming periods and/or extraordinary situations, alternative liquidity sources and placement areas. During preparation of projections for future cash flows based on these information, liquidity risk exposure of the Bank is measured using different scenarios (for example, credit collection ratios).

Besides, monthly proforma cash flows related to coverage ratios for medium and long term liabilities and balance sheet durations are monitored continuously in order to identify risk factors in advance. In the case situations creating risk are present; initiatives are taken by related departments to eliminate this situation. In order to evaluate the effects of negative developments at the parameters that affect the financial strength of the Bank to operations and market risks, it is essential to apply stress tests and to use the results within the Bank's strategic decision making process.

Analyzing the structure of the Bank's assets and borrowings, loans provided by international financial institutions consists of medium and long-term loans with floating interest rate, and these funds are disbursed by taking into account the re-pricing period. Balance sheet mainly consists of loans that, given the impact of interest rate shocks on the profitability is thought to be limited to a portfolio of liquid assets and liabilities. In addition, the share of the equity in liabilities thus released funds is high and it makes the Bank advantageous in the liquidity risk management. Assessment of maturity/yield alternatives for the placement of liquidity surplus and maturity/cost alternatives to meet liquidity needs is the basic principle of the Bank liquidity management.

Analysis of financial liabilities by remaining contractual maturities:

As of 31 December 2017	**Up to 1 Month**	**1-3 Months**	**3-12 Months**	**1-5 Years**	**Over 5 Years**	**Adjustment**	**Total**
Liabilities							
Funds borrowed	63,139	88,519	469,212	3,464,548	3,877,580	(378,478)	7,584,520
Obligations under repurchase agreements	130	-	-	-	-	-	130
Total	**63,269**	**88,519**	**469,212**	**3,464,548**	**3,877,580**	**(378,478)**	**7,584,650**

As of 31 December 2016	**Up to 1 Month**	**1-3 Months**	**3-12 Months**	**1-5 Years**	**Over 5 Years**	**Adjustment**	**Total**
Liabilities							
Funds borrowed	33,392	78,311	325,823	2,450,824	3,440,162	(528,005)	5,800,507
Obligations under repurchase a	351	-	-	-	-	-	351
Total	**33,743**	**78,311**	**325,823**	**2,450,824**	**3,440,162**	**(528,005)**	**5,800,858**

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

24. FINANCIAL RISK MANAGEMENT (continued)

Presentation according to remaining period at balance sheet date to contractual maturities:

As of 31 December 2017	Demand	Up to 1 Month	1-3 Months	3-12 Months	1 year to 5 years	Over 5 years	Undistributed	Total
Assets								
Cash and cash equivalents	13,063	1,277,212	44,999	-	-	-	-	1,335,274
Balances with Central Bank	626	-	-	-	-	-	-	626
Money market placements	-	326,024	-	-	-	-	-	326,024
Investment securities available-for-sale	8,037	6,353	16,890	124,987	101,074	-	-	257,341
Loans and advances to customers and financial institutions	-	131,453	102,452	741,194	3,890,708	2,012,511	24,463	6,902,781
Other assets	-	-	-	-	-	-	153,086	153,086
Total assets	**21,726**	**1,741,042**	**164,341**	**866,181**	**3,991,782**	**2,012,511**	**177,549**	**8,975,132**
Liabilities and equity								
Funds provided from other financial institutions	-	62,182	86,137	416,141	3,147,482	3,619,808	252,770	7,584,520
Obligations under repurchase agreements	-	130	-	-	-	-	-	130
Other liabilities	18,622	1,244	7,819	-	-	-	42,191	69,876
Total liabilities	**18,622**	**63,556**	**93,956**	**416,141**	**3,147,482**	**3,619,808**	**294,961**	**7,654,526**
Liquidity gap	**3,104**	**1,677,486**	**70,385**	**450,040**	**844,300**	**(1,607,297)**	**(117,412)**	**1,320,606**

As of 31 December 2016	Demand	Up to 1 Month	1-3 Months	3-12 Months	1 year to 5 years	Over 5 years	Undistributed	Total
Total assets	366,523	1,062,488	141,720	531,398	3,053,551	1,685,114	178,299	7,019,093
Total liabilities	18,114	34,355	80,255	276,057	2,197,914	3,220,829	383,099	6,210,623
Liquidity gap	**348,409**	**1,028,133**	**61,465**	**255,341**	**855,637**	**(1,535,715)**	**(204,800)**	**808,470**

(*) Assets which are required for banking operations and could not be converted into cash in short-term, such as; tangible assets, associates, subsidiaries, office supply inventory, prepaid expenses and non-performing loans; and other liabilities such as provisions which are not considered as payables are classified as undistributed.

(**) Deferred tax asset is included under the "Undistributed" column.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

24. FINANCIAL RISK MANAGEMENT (continued)

Market Risk

Market risk is calculated within the scope of the "Regulation on Measurement and Assessment of Capital Adequacy Ratios of Banks" published in the Official Gazette dated 28 June 2012 and numbered 28337 and legally reported.

Besides monthly calculation made as per standard method, market risk is calculated daily as per Value at Risk ("VaR") method and reported to top management. Calculations are made using Historical Simulation method. In order to test the reliability of the VaR model, back tests are performed. Stress tests are also applied in order to reflect the effects of prospective severe market fluctuations in the market parameters on income statement.

In compliance with the "Regulation on Banks' Internal Control and Risk Management Systems" published in the Official Gazette dated 28 June 2012 and numbered 28337, Board of Directors determine risk limits considering the major risks beared by the Bank and revise these limits based the market conditions and the strategies of the Bank.

The reports prepared for the monitoring of the risk limits are regularly submitted to the Board of Directors, Audit Committee and top management.

Currency Risk

Foreign currency risk indicates the possibilities of potential losses that banks are subject to due to the exchange rate movements in the market. While calculating the share capital requirement, all foreign currency assets, liabilities and forward transactions of the Group are taken into account, net short and long position of the Turkish Lira equivalent to each foreign currency is calculated.

Standard method determined for legal reporting is used in the calculation of the exchange rate risk faced by the Bank.

In addition, daily currency risk faced by the Bank can be determined by the foreign currency balance sheets that are prepared to include singular positions. Proforma foreign currency balance sheets are used in the calculation of the future possible exchange rate risk (including foreign currency based assets and liabilities). To limit the amount of currency risk exposed, a non-speculative foreign currency position risk management is adopted and used in the distribution of balance sheet and off-balance sheet assets according to their currencies.

Foreign currency sensitivity:

The Group is mainly exposed to EUR and USD currency risk.

The following table details the Group's sensitivity to a 10% increase and decrease in the USD or EUR foreign exchange rates, 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign exchange rates.

	Change in currency rate in %	Increase/(Decrease) Effect on profit / loss (*)		Increase/(Decrease) Effect on equity	
		31 December 2017	**31 December 2016**	**31 December 2017**	**31 December 2016**
USD	10 increase	66	304	1,144	(254)
USD	10 decrease	(66)	(304)	(1,144)	254
EURO	10 increase	(2,649)	2,191	2,382	(672)
EURO	10 decrease	2,649	(2,191)	(2,382)	672
Other	10 increase	29	26	29	26
Other	10 decrease	(29)	(26)	(29)	(26)

(*) Tax effect excluded.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

24. FINANCIAL RISK MANAGEMENT (continued)

The Group's sensitivity to foreign currency rates has not changed much during the current period. The positions taken in line with market expectations can increase the foreign currency sensitivity from period to period.

The concentrations of assets, liabilities and off balance sheet items in various currencies are:

	EURO	USD	Other FC	Total
As of 31 December 2017				
Assets				
Due from other banks and financial institutions	760,748	149,126	290	910,164
Investment securities available-for-sale	61,390	39,511	-	100,901
Loans and advances to customers and financial institutions	3,750,276	2,787,321	-	6,537,597
Investments in associates	37,305	-	-	37,305
Other assets	282	2,015	-	2,297
Total assets	**4,610,001**	**2,977,973**	**290**	**7,588,264**
Liabilities				
Funds provided from other financial institutions	4,595,470	2,972,435	-	7,567,905
Miscellaneous liabilities	887	4,209	-	5,096
Other liabilities	2,829	669	-	3,498
Total liabilities	**4,599,186**	**2,977,313**	**-**	**7,576,499**
Net on balance sheet position	**10,815**	**660**	**290**	**11,765**
Net off balance sheet position	**-**	**-**	**-**	**-**
Non-cash loans	772	-	-	772
As of 31 December 2016				
Total assets	**3,353,487**	**2,477,645**	**259**	**5,831,391**
Total liabilities	**3,324,098**	**2,474,493**	**-**	**5,798,696**
Net on balance sheet position	**29,389**	**3,152**	**259**	**32,800**
Net off balance sheet position	**-**	**-**	**-**	**-**
Non-cash loans	22,857	61,545	-	84,402

24. FINANCIAL RISK MANAGEMENT (continued)

Interest Rate Risk

The Bank's basic principle in the interest rate risk management policy is to provide alignment by parallelism between loans disbursed with fixed and floating rate and funds provided with fixed and floating rate. Accordingly, interest rate, currency and maturity alignment material is respected during the disbursement of loans funded by foreign long-term borrowings, which form the material part of the loan portfolio. Almost the entire loan portfolio is financed by floating rate borrowings, then interest rate risk from changes in interest rates seems not probable for the loan portfolio because of the correlation provided between the source and the uses. Other loans in the portfolio are financed by the equity of the Bank.

Within the framework of the Bank's basic principle of interest rate risk policy, optimization of portfolio distribution in the management of interest-sensitive assets other than loans is provided by considering possible changes in duration of positions and current interest rate limits; by taking into account alternative return, limits of tolerable loss and risk. In this context, to measure the interest rate risk exposure of the Bank, the effect of days to maturity and profit/loss are analyzed considering the scenarios of possible changes in interest rates for securities portfolio. Alternatives for compensation of probable losses that may arise as a result of fluctuations in market interest are examined using different markets. Interest rate sensitivity analysis is also made for the positions besides securities portfolio.

In order to minimize the possibility of unfavorable effects of market interest rate changes on the Bank's financial position, risk limits are used for the management of interest rate risk. These limits are set by Asset-Liability Committee and approved by Board of Directors. The Bank monitors and controls whether interest-sensitive assets are within the determined limits.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

24. FINANCIAL RISK MANAGEMENT (continued)

Interest rate sensitivity based on repricing dates:

As of 31 December 2017	Up to 1 month	1 to 3 months	3 to 12 months	1 year to 5 years	Over 5 years	Non-interest Bearing	Total
Assets							
Cash and cash equivalents	1,277,212	44,999	-	-	-	13,063	1,335,274
Balances with Central Bank	-	-	-	-	-	626	626
Money market placements	326,024	-	-	-	-	-	326,024
Investment securities available-for-sale	5,234	16,755	123,941	103,374	-	8,037	257,341
Loans and advances to customers and financial institutions	1,881,540	1,028,532	1,909,365	187,151	1,871,730	24,463	6,902,781
Other assets						153,086	153,086
Total assets	3,490,010	1,090,286	2,033,306	290,525	1,871,730	199,275	8,975,132
Liabilities and equity							
Obligations under repurchase agreements	130	-	-	-	-	-	130
Funds provided from other financial institutions	1,215,546	1,263,276	2,959,991	1,134,407	1,011,300	-	7,584,520
Other liabilities	-	-	-	-	-	69,876	69,876
Total liabilities	1,215,676	1,263,276	2,959,991	1,134,407	1,011,300	69,876	7,654,526

As of 31 December 2016	Up to 1 month	1 to 3 months	3 to 12 months	1 year to 5 years	Over 5 years	Non-interest Bearing	Total
Total assets	2,452,684	954,999	1,764,136	166,972	1,135,480	544,822	7,019,093
Total liabilities	873,363	1,122,836	2,526,098	590,277	688,286	409,763	6,210,623

24. FINANCIAL RISK MANAGEMENT (continued)

Capital Adequacy

To monitor the adequacy of its capital, the Group uses ratios established by Banking Regulation and Supervision Agency (BRSA). The minimum ratio is 8%. These ratios measure capital adequacy by comparing the Group's eligible capital with its balance sheet assets, off-balance sheet commitments and market and other risk positions at weighted amounts to reflect their relative risk. The Bank operates only in domestic markets.

Beginning from 1 July 2012, capital adequacy ratio is calculated within the scope of the "Regulation on Measurement and Assessment of Capital Adequacy Ratios of Banks" (the "Regulation") published in the Official Gazette dated 28 June 2012 and numbered 28337 and "Communiqué on Credit Risk Mitigation Techniques" published in the Official Gazette dated 5 September 2013 and numbered 28756.

In capital adequacy standard ratio calculation, based upon the data prepared from accounting records in compliance with the current legislation, the Standard Method is used to calculate capital adequacy for Credit Risk and Market Risk and Basic Indicator Approach is used annually for Operational Risk.

In calculation of value at credit risk, the Bank assesses credit items in related risk weights by considering risk categories, rating notes and other risk reducing factors under the framework of "Communiqué on Credit Risk Mitigation Techniques".

The non-cash loans and commitments and the receivables from counterparties in such transactions are weighted after netting with specific provisions that are calculated based on the "Regulation on Procedures and Principles for Determination of Qualification of Loans and Other Receivables, and Allocation of Provisions" and classified under liabilities. The net amounts are then multiplied by the rates stated in the Article 5 of the Regulation, reduced as per the "Communiqué on Credit Risk Mitigation Techniques" and then included in the relevant risk classification defined in the article 6 and weighted as per Appendix-1 of the Regulation.

As per the article 5 of the Regulation, the "counterparty credit risk" is calculated for repurchase and reverse repurchase agreements.

As of 31 December 2017, its capital adequacy ratio on an unconsolidated basis is 16.73% (31 December 2016: 13.41%).

Operational Risk

Operational risk is defined as the probability of loss or damage due to the overlooked errors and irregularities arising from failures of the internal controls of the Bank, and not responding timely by the Bank's management and the personnel, errors and irregularities of the information systems, and due to the disasters like earthquake, fire or flood, or terrorist attacks. From this point, all major operation groups include operational risk.

The Bank manages operational risk according to volume, nature and complexity of operations and within the context of BRSA regulations; accepts that operational risk management covers all operations and personnel. The basic principle of operational risk management policy is to take precautions to prevent realization of risks. Intensification of controls over each stage of business processes that are determined by the Bank is the most effective policy tool of operational risk management.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

24. FINANCIAL RISK MANAGEMENT (continued)

Fair Value of financial instruments

	Carrying amount		Fair value	
	31 December 2017	**31 December 2016**	**31 December 2017**	**31 December 2016**
Financial assets				
Loans and advances	6,902,781	5,389,090	6,943,144	5,423,363
Investment securities available-for-sale	257,341	193,400	257,341	193,400
Investment securities held-to-maturity	--	20,415	-	20,407
	7,160,122	5,602,905	7,200,485	5,637,170
Financial liabilities				
Obligations under repurchase agreements	130	351	130	351
Funds Provided from Other Financial Institutions	7,584,520	5,800,507	7,628,094	5,814,907
Sundry Creditors	18,622	18,114	18,622	18,114
	7,603,272	5,818,972	7,646,846	5,833,372

(*) Financial assets and liabilities presented above include interest accruals.

Methods and estimations used for the fair value determination of financial instruments which are not presented with their fair values in financial statements:

i- For the fair value determination of loans, interest rates as of balance sheet date are considered,
ii- For the fair value determination of banks, interest rates as of balance sheet date are considered,
iii- For the fair value determination of investments held-to-maturity, market prices as of balance sheet date are considered.

The fair values of financial assets and financial liabilities are determined as follows:

• Level 1: The fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices;
• Level 2: The fair value of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions; and
• Level 3: The fair value of derivative instruments, are calculated using quoted prices, Where such prices are not available use is made of discounted cash flow analysis using the applicable yield curve for the duration of the instruments for non-optional derivatives, and option pricing models for optional derivatives.

Amounts expressed in thousands of Turkish Lira (TRY) unless otherwise stated.

24. FINANCIAL RISK MANAGEMENT (continued)

Fair Value of financial instruments (continued)

31 December 2017	Level 1	Level 2	Level 3
Financial assets available-for-sale (*)	**148,403**	**100,901**	-
Debt securities	148,403	100,901	-
Other	-	-	-

(*) Since they are not traded in an active market, share certificates under financial assets available-for-sale are shown in the financial statements with their acquisition costs, therefore not included in the table.

31 December 2016	Level 1	Level 2	Level 3
Financial assets available-for-sale (*)	**185,352**	-	-
Debt securities	185,352	-	-
Other	-	-	-

(*) Since they are not traded in an active market, share certificates under financial assets available-for-sale are shown in the financial statements with their acquisition costs, therefore not included in the table.

25. SUBSEQUENT EVENTS

None.