

**TÜRKİYE
KALKINMA BANKASI A.Ş.
AND ITS SUBSIDIARY**

CONSOLIDATED
FINANCIAL STATEMENTS
FOR THE YEAR ENDED
31 DECEMBER 2016 AND
INDEPENDENT AUDITOR'S
REPORT

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Türkiye Kalkınma Bankası A.Ş.
Ankara, Turkey

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the accompanying consolidated financial statements of Türkiye Kalkınma Bankası A.Ş. (the “Bank”) and its subsidiaries (the “Group”), which comprise the consolidated statement of financial position as at 31 December 2016, the consolidated statement of 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 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (“IFRSs”).

Basis for Qualified Opinion

The audited financial statements as at 31 December 2016 of Arıcak Turizm ve Ticaret A.Ş. (“Arıcak”), Maksan Malatya Makina Sanayi A.Ş. (“Maksan”) and Istanbul Venture Capital Investment (“IVCI”), associates of the Bank with a 99.71%, 31.14% and 6.2% ownership, respectively, prepared in accordance with International Financial Reporting Standards are not available as of the reporting date. Unaudited financial statements based on statutory accounts are taken into account in consolidation of Arıcak and in the equity accounting of Maksan and IVCI in the accompanying consolidated financial statements. Total assets and net loss for the period of Arıcak is TRY 9,165 Thousand and 400 TRY Thousand, respectively. Maksan and IVCI are presented under investments in associates with a participation value of TRY 4,802 Thousand (31 December 2015: TRY 4,545 Thousand) and TRY 25,969 Thousand (31 December 2015: TRY 16,849 Thousand), respectively. Therefore, no opinion could be formed regarding the effect of financial position, off-balance sheet transactions and result of operations of Arıcak, Maksan and IVCI on the accompanying consolidated financial statements.

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”), 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 Matters

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.

| Key Audit Matter | How the matter was addressed in the audit |
|---|---|
| <p>Allowance for probable losses on loans and advances</p> <p>At 31 December 2016, gross loans and advances to customers were TL 5,470,199 thousands against which loan allowance for impairment of TL 81,109 thousands were recorded ending with a net carrying amount of TL 5,389,090 thousands. The details are disclosed in Note 6 of the consolidated financial statements.</p> <p>For specific allowances, a management decision and judgement is required to determine when an impairment event has occurred and a necessary classification should be done. So there is a risk of misstatement in the calculation of the allowance related to the classification of performing / non-performing loans in accordance with IAS 39.</p> <p>Furthermore, the specific allowances are made against the carrying amount of loans and receivables that are identified as being impaired based on regular reviews of outstanding balances to reduce these loans and receivables to their recoverable amounts. In assessing the recoverable amounts of the loans and receivables, the estimated future cash flows are discounted to their present value using the average interest rate applied for loans and advances.</p> <p>Portfolio basis (collective) allowances are maintained to reduce the carrying amount of portfolios of similar loans and receivables to their estimated recoverable amounts at the date of financial position. Probability of default and recovery on default ratios are used to calculate the collective provision. These ratios are estimated based on average of previous years' actualized defaults and recoveries on those defaults.</p> <p>Because of the significance of these judgements and the size of loans and advances, the audit of allowance for probable losses on loans and advances is a key area of focus. Furthermore, there is a risk of misstatement in the calculation of allowance related to errors in the main parameters of allowance for probable losses on loans and advances (specific and collective) in accordance with IAS 39 in the IFRS financial statements.</p> | <p>We reviewed the provisioning methodology implemented by the Group. We understood and tested the key controls over the classification and provisioning methodology such as; system based and manual controls over the timely recognition of impaired loans, controls over the impairment calculation models including data inputs and controls over cash flow estimates.</p> <p>We performed a loan review process by testing a sample of loans to form our own assessment as to whether impairment events had occurred and to assess whether impairments had been identified in a timely manner. We tested the assumptions underlying the impairment identification and quantification including forecasts of future cash flows, valuation of underlying collateral and estimates of recovery on default. For allowances calculated on a collective basis we tested the underlying model. We also tested the appropriateness and accuracy of the inputs to those models, such as probability of default and loss given default rates, and compared data and assumptions with previous ones. Finally, we understood and tested the controls over related disclosures.</p> |

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.

The engagement partner on the audit resulting in this independent auditor's report is Hasan Kılıç.

DRT BAĞIMSIZ DENETİM VE SERBEST MUHASEBECİ MALİ MÜŞAVİRLİK A.Ş.

Member of **DELOITTE TOUCHE TOHMATSU LIMITED**



Hasan Kılıç
Partner

İstanbul, 28 April 2017

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TÜRKİYE KALKINMA BANKASI ANONİM ŞİRKETİ AND ITS SUBSIDIARY
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2016

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

| | Notes | 31 December 2016 | 31 December 2015 |
|---|-------|---------------------|---------------------|
| ASSETS | | | |
| Cash and deposits with banks and other financial institutions | 4 | 1,265,476 | 525,087 |
| Balances with Central Bank | 4 | 1,020 | 200 |
| Money market placements | 4 | 10,505 | 35,010 |
| Loans and advances to customers | 6 | 4,989,053 | 3,519,176 |
| Loans and advances to financial institutions | 6 | 400,037 | 371,091 |
| Investment securities: | | 213,815 | 185,007 |
| - Available-for-sale | 5 | 193,400 | 164,475 |
| - Held-to-maturity | 5 | 20,415 | 20,532 |
| Investments in associates | 7 | 36,071 | 25,586 |
| Premises and equipment | 8 | 42,225 | 36,708 |
| Investment properties | 9 | 8,912 | 9,279 |
| Intangible assets | | 1,531 | 1,163 |
| Deferred tax asset | 13 | 3,982 | 3,382 |
| Other assets | 10 | 46,466 | 44,122 |
| Total assets | | 7,019,093 | 4,755,811 |
| LIABILITIES AND EQUITY | | | |
| LIABILITIES | | | |
| Obligations under repurchase agreements | | 351 | 226 |
| Funds borrowed | 11 | 5,800,509 | 3,974,371 |
| Other liabilities and provisions | 12 | 402,220 | 50,227 |
| Income taxes payable | 13 | 7,543 | 5,173 |
| Total liabilities | | 6,210,623 | 4,029,997 |
| EQUITY | | | |
| Equity attributable to equity holders of the parent | | | |
| Share capital issued | 14 | 1,450,923 | 1,450,923 |
| Share premium | | 1,557 | 1,557 |
| Actuarial gain | | 1,730 | 892 |
| Unrealized gains/(losses) on available-for-sale investments, net of tax | | (101) | (15) |
| Legal reserves | | 76,216 | 76,216 |
| Retained earnings | | (721,855) | (803,759) |
| Total equity | | 808,470 | 725,814 |
| Total liabilities and equity | | 7,019,093 | 4,755,811 |

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

TÜRKİYE KALKINMA BANKASI ANONİM ŞİRKETİ AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENT OF PROFIT OR LOSS
FOR THE YEAR ENDED 31 DECEMBER 2016

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

| | Notes | 1 January – 31 December 2016 | 1 January – 31 December 2015 |
|---|-------|------------------------------------|------------------------------------|
| Interest income | | | |
| Interest on loans and advances | | 171,062 | 140,246 |
| Interest on securities | 18 | 11,972 | 10,635 |
| Interest on deposits with banks and other financial institutions | | 29,490 | 11,023 |
| Interest on other money market placements | | 6,509 | 22,754 |
| Other interest income | | 858 | 1,467 |
| Total interest income | | 219,891 | 186,125 |
| Interest expense | | | |
| Interest on money market operations | | (42) | (22) |
| Interest on funds borrowed and deposits from other banks | | (53,988) | (40,341) |
| Other interest expense | | (6) | (82) |
| Total interest expense | | (54,036) | (40,445) |
| Net interest income | | 165,855 | 145,680 |
| Fees and commissions and other operating income | | | |
| Fees and commissions income | 21 | 20,001 | 10,655 |
| Fees and commissions expenses | 21 | (405) | (664) |
| Net fees and commissions income | | 19,596 | 9,991 |
| Foreign exchange gains | | 5,325 | 2,939 |
| Gains on securities | | 9 | 2,795 |
| Other operating income | 19 | 9,419 | 2,684 |
| Other operating expenses | 20 | (84,020) | (78,941) |
| (Provisions for) / recoveries from impairment of loans and other assets | | (17,751) | (1,221) |
| Operating profit | | 98,433 | 83,927 |
| Income from associates | 7 | 5,116 | 1,016 |
| Profit before income tax | | 103,549 | 84,943 |
| Income tax expense | 13 | (21,645) | (17,652) |
| Profit for the year | | 81,904 | 67,291 |
| Profit attributable to: | | | |
| Equity holders of the parent | | 81,904 | 67,291 |
| Earnings per share (per 100 shares) | 16 | 0.5119 | 0.4206 |

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

TÜRKİYE KALKINMA BANKASI ANONİM ŞİRKETİ AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2016

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

| | Notes | 1 January – 31 December 2016 | 1 January – 31 December 2015 |
|---|-------|------------------------------------|------------------------------------|
| Profit for the year | | 81,904 | 67,291 |
| Other comprehensive income | | | |
| <i>Items that will not be reclassified subsequently to profit or loss:</i> | | | |
| Actuarial gain/(loss) | | 1,048 | 433 |
| Tax effect of actuarial gain/(loss) | | (210) | (87) |
| <i>Items that may be reclassified subsequently to profit or loss:</i> | | | |
| Net value gains / (losses) on available-for-sale financial assets | | (108) | (3,038) |
| Tax effect of net value gains/ (losses) on available for sale financial assets | | 22 | 608 |
| Other comprehensive income / (loss) for the year, net of tax | | 752 | (2,084) |
| Total comprehensive income for the year | | 82,656 | 65,207 |
| Total comprehensive income attributable to: | | | |
| Equity holders of the parent | | 82,656 | 65,207 |
| 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 SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2016

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

| | Share capital | Share Premium | Actuarial gain/(loss) | Unrealized gains/(losses) on available-for-sale investments | Legal Reserves | Retained earnings | Total Equity |
|---|------------------|---------------|-----------------------|---|----------------|-------------------|----------------|
| At 31 December 2014 | 1,450,923 | 1,557 | 546 | 2,415 | 76,216 | (871,050) | 660,607 |
| Profit for the year | - | - | - | - | - | 67,291 | 67,291 |
| Actuarial gain/(loss): | - | - | - | - | - | - | - |
| Gains/(Losses) arising during the year | - | - | 433 | - | - | - | 433 |
| Available for sale financial assets: | - | - | - | - | - | - | - |
| Gains/(Losses) arising during the year | - | - | - | (3,038) | - | - | (3,038) |
| Less: Transfer to statement of income | - | - | - | - | - | - | - |
| Income tax relating to components of other comprehensive income | - | - | (87) | 608 | - | - | 521 |
| Other comprehensive income | - | - | 346 | (2,430) | - | - | (2,084) |
| Total comprehensive income for the year | - | - | 346 | (2,430) | - | 67,291 | 65,207 |
| At 31 December 2015 | 1,450,923 | 1,557 | 892 | (15) | 76,216 | (803,759) | 725,814 |
| Profit for the year | - | - | - | - | - | 81,904 | 81,904 |
| Actuarial gain/(loss): | - | - | - | - | - | - | - |
| Gains/(Losses) arising during the year | - | - | 1,048 | - | - | - | 940 |
| Available for sale financial assets: | - | - | - | - | - | - | - |
| Gains/(Losses) arising during the year | - | - | - | (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 | 1,450,923 | 1,557 | 1,730 | (101) | 76,216 | (721,855) | 808,470 |

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

TÜRKİYE KALKINMA BANKASI ANONİM ŞİRKETİ AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2016

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

| | Notes | 1 January – 31 December 2016 | 1 January – 31 December 2015 |
|--|-------|---------------------------------|---------------------------------|
| Cash flows from operating activities | | | |
| Interest received | | 205,425 | 178,351 |
| Interest paid | | (48,056) | (38,841) |
| Fees and commissions received | | 20,001 | 10,655 |
| Fees and commissions paid | | (405) | (664) |
| Trading (income)/losses | | 9 | 2,795 |
| Recoveries of impairment of loan | | - | (109) |
| Cash payments to employees and other parties | | (58,671) | (54,905) |
| Unrealized foreign exchange gains | | 76,519 | 39,661 |
| (Gain) on sale of premises and equipment | | (347) | (796) |
| Other operating activities | | (64,650) | (48,232) |
| Income taxes paid | | (21,341) | (15,636) |
| Cash flows from operating activities before changes in operating assets and liabilities | | 108,484 | 72,279 |
| Changes in operating assets and liabilities | | | |
| Net (increase)/decrease in trading securities | | - | 1 |
| Net (increase)/decrease in loans and advances to customers | | (733,946) | (180,120) |
| Net (increase)/decrease in loans and advances to financial institutions | | (28,891) | (33,166) |
| Net (increase)/decrease in other assets | | 2,152 | 2,674 |
| Net increase/(decrease) in other liabilities | | 355,314 | (10,637) |
| Net cash used in operating activities | | (296,878) | (148,969) |
| Cash flows from investing activities | | | |
| Purchases of available for sale securities | | (118,396) | (127,085) |
| Proceeds from sale and redemption of available for sale securities | | 87,824 | 44,399 |
| Purchases of held to maturity investments | | 5 | (8) |
| Proceeds from redemption of held to maturity investments | | 37 | 40 |
| Purchases of premises and equipment | 8 | (1,860) | (1,800) |
| Proceeds from sale of premises and equipment | | 353 | 795 |
| Purchases of intangible assets | | (1,355) | (184) |
| Purchases of equity participations | | (8,939) | (3,160) |
| Net cash provided / (used in) from investing activities | | (42,331) | (87,004) |
| Cash flows from financing activities | | | |
| Net increase/(decrease) in obligations under repurchase agreements | | 125 | (6) |
| Proceeds from funds borrowed | | 1,005,607 | 208,727 |
| Net cash provided by / (used in) financing activities | | 1,005,732 | 208,721 |
| Effect of net foreign exchange difference | | 49,143 | 25,891 |
| Net increase/(decrease) in cash and cash equivalents | | 715,657 | (1,361) |
| Cash and cash equivalents at the beginning of the year | 4 | 559,995 | 561,356 |
| Cash and cash equivalents at the end of the year | 4 | 1,275,652 | 559,995 |

**TÜRKİYE KALKINMA BANKASI ANONİM ŞİRKETİ AND ITS SUBSIDIARY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016**

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

1. GENERAL INFORMATION ABOUT THE BANK

Türkiye Kalkınma Bankası A.Ş. ('the Bank') was founded in Ankara as Devlet Sanayi ve İşçi Yatırım Bankası in 1975, with the Decree in Force Law No 13 under the control of the Ministry of Industry. The primary function of the Bank was to support workers' initiatives to build and operate companies with the objective to utilize savings of expatriate workers.

The scope of the Bank was broadened to include wider developmental issues, and the Bank's name was changed to Türkiye Kalkınma Bankası A.Ş. in 1988 following a decision of the Council of Ministers.

With the decision of the "Supreme Planning Board" dated 20.01.1989, all of the assets and liabilities of the T.C. Turizm Bankası A.Ş. were transferred to Türkiye Kalkınma Bankası A.Ş.

On October 14, 1999 the Decree in Force Law No 13 which defines founding status of the Bank had become a law in the General Assembly of Turkish Republic with Law No 4456.

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.

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 markets, 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.

**TÜRKİYE KALKINMA BANKASI ANONİM ŞİRKETİ AND ITS SUBSIDIARY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016**

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Statement of Compliance

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

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 laws 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 the Group's entities.

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.

TÜRKİYE KALKINMA BANKASI ANONİM ŞİRKETİ AND ITS SUBSIDIARY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016

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 subsidiaries included in consolidation and effective shareholding percentages of the Group as of 31 December 2016 and 2015 are as follows:

| | Place of Incorporation | Effective Shareholding % | | Voting Rights % | |
|-------------|---------------------------|-----------------------------|---------------------|---------------------|---------------------|
| | | 31 December 2016 | 31 December 2015 | 31 December 2016 | 31 December 2015 |
| Arıcak A.Ş. | 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 are as follows:

| | Place of Incorporation | Effective Shareholding % | | Voting Rights % | |
|-------------------------------------|---------------------------|-----------------------------|---------------------|---------------------|---------------------|
| | | 31 December 2016 | 31 December 2015 | 31 December 2016 | 31 December 2015 |
| Istanbul Venture Capital Initiative | Luxemburg | 6.25% | 6.25% | 11.11% | 11.11% |
| Maksan A.Ş. | Malatya | 31.14% | 31.14% | 20.00% | 20.00% |
| Türk Suudi Holding A.Ş. | İstanbul | 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.

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

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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 2015 | 3.176 | 2.907 |
| 31 December 2016 | 3.685 | 3.503 |

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.10 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.

2.11 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.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.12 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.

2.13 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.

2.14 Investments and Other Financial Assets

The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments and available-for-sale financial assets. 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.

Effective interest method

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.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.14 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 2016 or 2015.

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.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.14 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.

2.15 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.

2.16 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.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.16 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.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.16 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.

2.17 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.

2.18 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.

2.19 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.

2.20 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.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.20 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.

2.21 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.

2.22 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.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.23 Interest Income and Expense Recognition

Interest Income and Expenses

Interest income and expenses 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.

2.24 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.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.24 Income Tax (continued)

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.

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.

2.25 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.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.26 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.

2.27 Application of New and Revised International Financial Reporting Standards

a) Amendments to IFRSs affecting amounts reported and/or disclosures in the consolidated financial statements

None.

b) New and Revised IFRSs applied with no material effect on the consolidated financial statements

| | |
|---|--|
| IFRS 14 | <i>Regulatory Deferral Accounts</i> ¹ |
| Amendments to IFRS 11 | <i>Accounting for Acquisition of Interests in Joint Operations</i> ¹ |
| Amendments to IAS 16 and IAS 38 | <i>Clarification of Acceptable Methods of Depreciation and Amortisation</i> ¹ |
| Amendments to IAS 16 and IAS 41 | <i>Agriculture: Bearer Plants</i> ¹ |
| Amendments to IAS 27 | <i>Equity Method in Separate Financial Statements</i> ¹ |
| Annual Improvements to 2012-2014 Cycle | <i>IFRS 5, IFRS 7, IAS 19, IAS 34</i> ¹ |
| Amendments to IAS 1 | <i>Disclosure Initiative</i> ¹ |
| Amendments to IFRS 10, IFRS 12 and IAS 28 | <i>Investment Entities: Applying the Consolidation Exception</i> ¹ |

¹ Effective for annual periods beginning on or after 1 January 2016.

IFRS 14 Regulatory Deferral Accounts

IFRS 14 Regulatory Deferral Accounts permits an entity, which is a first-time adopter of International Financial Reporting Standards to continue to account, with some limited changes, for 'regulatory deferral account balances' in accordance with its previous GAAP, both on initial adoption of IFRS and in subsequent financial statements.

IFRS 14 was issued by the IASB on 30 January 2014 and is applied to an entity's first annual IFRS financial statements for a period beginning on or after 1 January 2016.

Amendments to IFRS 11 Accounting for Acquisition of Interests in Joint Operations

This amendment requires an acquirer of an interest in a joint operation in which the activity constitutes a business to:

- apply all of the business combinations accounting principles in IFRS 3 and other IFRSs, except for those principles that conflict with the guidance in IFRS 11,
- disclose the information required by IFRS 3 and other IFRSs for business combinations.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.27 Application of New and Revised International Financial Reporting Standards (continued)

b) New and Revised IFRSs applied with no material effect on the consolidated financial statements (continued)

Amendments to IAS 16 and IAS 38 Clarification of Acceptable Methods of Depreciation and Amortisation

This amendment clarifies that a depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate for property, plant and equipment, and introduces a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate, which can only be overcome in limited circumstances where the intangible asset is expressed as a measure of revenue, or when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated. The amendment also adds guidance that expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technological or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

Amendments to IAS 16 and IAS 41 Agriculture: Bearer Plants

This amendment includes 'bearer plants' within the scope of IAS 16 rather than IAS 41, allowing such assets to be accounted for on a property, plant and equipment and measured after initial recognition on a cost or revaluation basis in accordance with IAS 16. The amendment also introduces a definition of 'bearer plants' as a living plant that is used in the production or supply of agricultural produce, is expected to bear produce for more than one period and has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales, and clarifies that produce growing on bearer plants remains within the scope of IAS 41.

Amendments to IAS 27 Equity Method in Separate Financial Statements

This amendment permits investments in subsidiaries, joint ventures and associates to be optionally accounted for using the equity method in separate financial statements.

Annual Improvements 2012-2014 Cycle

IFRS 5: Adds specific guidance in IFRS 5 for cases in which an entity reclassifies an asset from held for sale to held for distribution or vice versa and cases in which held-for-distribution accounting is discontinued.

IFRS 7: Additional guidance to clarify whether a servicing contract is continuing involvement in a transferred asset, and clarification on offsetting disclosures in condensed interim financial statements.

IAS 19: Clarify that the high quality corporate bonds used in estimating the discount rate for post-employment benefits should be denominated in the same currency as the benefits to be paid.

IAS 34: Clarify the meaning of 'elsewhere in the interim report' and require a cross-reference.

Amendments to IAS 1 Disclosure Initiative

This amendment addresses perceived impediments to preparers exercising their judgment in presenting their financial reports.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.27 Application of New and Revised International Financial Reporting Standards (continued)

b) New and Revised IFRSs applied with no material effect on the consolidated financial statements (continued)

Amendments to IFRS 10, IFRS 12 and IAS 28 *Investment Entities: Applying the Consolidation Exception*

This amendment addresses issues that have arisen in the context of applying the consolidation exception for investment entities by clarifying the following points:

- The exemption from preparing consolidated financial statements for an intermediate parent entity is available to a parent entity that is a subsidiary of an investment entity, even if the investment entity measures all of its subsidiaries at fair value.
- A subsidiary that provides services related to the parent's investment activities should not be consolidated if the subsidiary itself is an investment entity.
- When applying the equity method to an associate or a joint venture, a non-investment entity investor in an investment entity may retain the fair value measurement applied by the associate or joint venture to its interests in subsidiaries.
- An investment entity measuring all of its subsidiaries at fair value provides the disclosures relating to investment entities required by IFRS 12.

b) New and revised IFRSs in issue but not yet effective

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

| | |
|----------------------------------|--|
| Amendments to IFRS 10 and IAS 28 | <i>Sale or Contribution of Assets between an Investor and its Associate or Joint Venture</i> |
| Amendments to IAS 12 | <i>Recognition of Deferred Tax Assets for Unrealized Losses</i> ¹ |
| Amendments to IAS 7 | <i>Disclosure Initiative</i> ¹ |
| IFRS 9 | <i>Financial Instruments</i> ² |
| IFRS 15 | <i>Revenue from Contracts with Customers</i> ² |
| Amendments to IFRS 15 | <i>Revenue from Contracts with Customers</i> ² |
| Amendments to IFRS 2 | <i>Classification and Measurement of Share-Based Payment Transactions</i> ² |
| IFRS 16 | <i>Leases</i> ³ |
| Amendments to IFRS 4 | |

Applying IFRS 9 'Financial Instruments' with IFRS 4 'Insurance Contracts'

| | |
|----------------------|--|
| Amendments to IAS 40 | <i>Transfers of Investment Property</i> ² |
|----------------------|--|

¹ Effective for annual periods beginning on or after 1 January 2017.

² Effective for annual periods beginning on or after 1 January 2018.

³ Effective for annual periods beginning on or after 1 January 2019.

Amendments to IFRS 10 and IAS 28 *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*

This amendment clarifies the treatment of the sale or contribution of assets from an investor to its associate or joint venture.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.27 Application of New and Revised International Financial Reporting Standards (continued)

c) New and revised IFRSs in issue but not yet effective (continued)

Amendments to IAS 12 Recognition of Deferred Tax Assets for Unrealized Losses

This amendment clarifies the following aspects:

- Unrealized losses on debt instruments measured at fair value and measured at cost for tax purposes give rise to a deductible temporary difference regardless of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use.
- The carrying amount of an asset does not limit the estimation of probable future taxable profits.
- Estimates for future taxable profits exclude tax deductions resulting from the reversal of deductible temporary differences.
- An entity assesses a deferred tax asset in combination with other deferred tax assets. Where tax law restricts the utilization of tax losses, an entity would assess a deferred tax asset in combination with other deferred tax assets of the same type.

Amendments to IAS 7 Disclosure Initiative

This amendment clarifies that entities shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities.

IFRS 9 Financial Instruments

IFRS 9, issued in November 2009, introduces new requirements for the classification and measurement of financial assets. IFRS 9 is amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition, and in November 2013 to include the new requirements for general hedge accounting. Another revised version of IFRS 9 is issued in July 2014 mainly to include a) impairment requirements for financial assets and b) limited amendments to the classification and measurement requirements by introducing a "fair value through other comprehensive income ("FVTOCI") measurement category for certain simple debt instruments.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 provides a single, principles based five-step model to be applied to all contracts with customers.

The five steps in the model are as follows:

- Identify the contract with the customer,
- Identify the performance obligations in the contract,
- Determine the transaction price,
- Allocate the transaction price to the performance obligations in the contracts,
- Recognise revenue when the entity satisfies a performance obligation.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.27 Application of New and Revised International Financial Reporting Standards (continued)

c) New and revised IFRSs in issue but not yet effective (continued)

Amendments to IFRS 15 Revenue from Contracts with Customers

This amendment clarifies three aspects of the standard (identifying performance obligations, principal versus agent considerations, and licensing) and provides some transition relief for modified contracts and completed contracts.

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

This amendment clarifies the standard in relation to the accounting for cash-settled share-based payment transactions that include a performance condition, the classification of share-based payment transactions with net settlement features, and the accounting for modifications of share-based payment transactions from cash-settled to equity settled.

IFRS 16 Leases

This new standard brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Lessor accounting however remains largely unchanged and the distinction between operating and finance leases is retained. IFRS 16 supersedes IAS 17 “Leases” and related interpretations and is effective for periods beginning on or after 1 January 2019, with earlier adoption permitted if IFRS 15 'Revenue from Contracts with Customers' has also been applied.

Amendments to IFRS 4 Applying IFRS 9 ‘Financial Instruments’ with IFRS 4 ‘Insurance Contracts’

This amendment provides optional approaches for entities that issue insurance contracts within the scope of IFRS 4, and the entities are permitted to stop applying them before the new insurance standard is applied.

Amendments to IAS 40 Transfers of Investment Property

The amendments to IAS 40 Investment Property:

- Amends paragraph 57 to state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management’s intentions for the use of a property by itself does not constitute evidence of a change in use.
- The list of examples of evidence in paragraph 57(a) – (d) is now presented as a non-exhaustive list of examples instead of the previous exhaustive list.

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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 2016 are as follows:

| | Treasury | Investment Banking | Tourism | 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 | - | - | (400) | (83,605) | (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 | (400) | (80,833) | (15) | 103,549 |
| Income tax | - | - | - | (21,645) | - | (21,645) |
| Net profit/(loss) | 47,549 | 137,461 | (400) | (102,478) | (15) | 81,904 |

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

| | Treasury | Investment Banking | Tourism | Undistributed | Eliminations | Group |
|-------------------------------------|------------------|-----------------------|--------------|------------------|--------------|------------------|
| Assets and Liabilities | | | | | | |
| Segment assets | 1,481,699 | 5,425,582 | 9,165 | 68,463 | (1,887) | 6,983,022 |
| Investment in associates | - | 31,781 | - | - | 4,290 | 36,071 |
| Total assets | 1,481,699 | 5,457,363 | 9,165 | 68,463 | 2,403 | 7,019,093 |
| Segment liabilities | 351 | 5,800,507 | 9,165 | 1,206,667 | 2,403 | 7,019,093 |
| Total liabilities and equity | 351 | 5,800,507 | 9,165 | 1,206,677 | 2,403 | 7,019,093 |
| Other segment items | | | | | | 358 |
| Capital expenditure | | | | | | 3,232 |
| Depreciation | | | | | | |

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3. SEGMENT INFORMATION (continued)

Business segments (continued)

The segment results for the year ended 31 December 2015 are as follows:

| | Treasury | Investment Banking | Tourism | Undistributed | Eliminations | Group |
|--|---------------|-----------------------|--------------|-----------------|--------------|----------------|
| Interest income | 44,412 | 140,246 | - | 1,467 | - | 186,125 |
| Interest expense | (22) | (40,423) | - | - | - | (40,445) |
| Net interest income | 44,390 | 99,823 | - | 1,467 | - | 145,680 |
| Fees and commissions income | - | 10,363 | - | 292 | - | 10,655 |
| Fees and commissions expenses | (664) | - | - | - | - | (664) |
| Foreign exchange gains/(losses) | 120 | 2,819 | - | - | - | 2,939 |
| Gains/(losses) on securities | 2,795 | - | - | - | - | 2,795 |
| Other operating income | 34 | 1,595 | - | 1,055 | - | 2,684 |
| Other operating expenses | - | - | (543) | (78,339) | (59) | (78,941) |
| (Provisions for) / impairment of loans and other assets | - | (1,058) | - | (163) | - | (1,221) |
| Income/(loss) from associates | - | 1,016 | - | - | - | 1,016 |
| Profit / (loss) before income tax | 46,675 | 114,558 | (543) | (75,688) | (59) | 84,943 |
| Income tax | - | - | - | (17,652) | - | (17,652) |
| Net profit/(loss) | 46,675 | 114,558 | (543) | (93,340) | (59) | 67,291 |

The segment assets and liabilities at 31 December 2015 are as follows:

| | Treasury | Investment Banking | Tourism | Undistributed | Eliminations | Group |
|-------------------------------------|----------------|-----------------------|--------------|----------------|----------------|------------------|
| Assets and Liabilities | | | | | | |
| Segment assets | 736,988 | 3,923,737 | 9,016 | 62,083 | (1,599) | 4,730,225 |
| Investment in associates | - | 28,794 | - | - | (3,208) | 25,586 |
| Total assets | 736,988 | 3,952,531 | 9,016 | 62,083 | (4,807) | 4,755,811 |
| Segment liabilities | 226 | 3,974,369 | 9,016 | 777,007 | (4,807) | 4,755,811 |
| Total liabilities and equity | 226 | 3,974,369 | 9,016 | 777,007 | (4,807) | 4,755,811 |

Other segment items

| | |
|---------------------|-------|
| Capital expenditure | 19 |
| Depreciation | 4,117 |

Geographical segments

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

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4. CASH AND CASH EQUIVALENTS

| | 31 December 2016 | 31 December 2015 |
|---|-----------------------------|-----------------------------|
| Cash on hand | 50 | 72 |
| Demand deposits - Turkish Lira | 345,789 | 3,257 |
| Demand deposits - Foreign Currency | 11,627 | 6,613 |
| Time deposits | 908,010 | 515,145 |
| Deposits with banks and other financial institutions | 1,265,426 | 525,015 |
| Cash and cash equivalents | 1,265,476 | 525,087 |
| Balances with Central Bank | 1,020 | 200 |
| Money market placements | 10,505 | 35,010 |
| Less: Interest accruals | (1,349) | (302) |
| Cash and cash equivalents in the statement of cash flows | 1,275,652 | 559,995 |

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

| | 31 December 2016 | | 31 December 2015 | |
|---|--------------------------------|-----------------------------|--------------------------------|-----------------------------|
| | Effective interest rate | | Effective interest rate | |
| | Turkish Lira | Foreign Currency | Turkish Lira | Foreign Currency |
| Deposits with banks and other financial institutions (*) | 9.21% | 0.62% | 11.06% | 0.33% |
| Money Market Placements | 8.49% | - | 10.75% | - |

(*) Interest rates calculated from weighted average of placements as of 31 December 2016 and 2015.

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5. INVESTMENTS IN FINANCIAL INSTRUMENTS

Financial assets at fair value through profit and loss:

Investment Securities:

| | 31 December 2016 | 31 December 2015 |
|---|-----------------------------|-----------------------------|
| | Amount | Amount |
| Available- for-sale securities at fair value | | |
| Turkish Government bonds issued by the Turkish Government | 185,352 | 156,431 |
| Available-for-sale securities at cost | | |
| Equity instruments –unlisted at cost (*) | 8,048 | 8,044 |
| Investment funds | - | - |
| Total available for sale securities | 193,400 | 164,475 |
| | | |
| | 31 December 2016 | 31 December 2015 |
| | Amount | Amount |
| Held to maturity securities at amortized cost | | |
| Turkish Government bonds (quoted) | 20,415 | 20,532 |
| Total held-to-maturity securities | 20,415 | 20,532 |

- (*) 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.

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5. INVESTMENTS IN FINANCIAL INSTRUMENTS (continued)

Government bonds and treasury bills pledged under repurchase agreements with customers amount to TRY 392 Thousand (31 December 2015: TRY 249) and none in the current period (31 December 2015: None) included in available for sale securities and held to maturity securities, respectively. Related liability is equal to TRY 351 Thousand (31 December 2015: TRY 226 Thousand) in the current period. In addition, as of 31 December 2016, government securities with carrying values of none in the current period (31 December 2015: None) in financial assets at fair value through profit or loss portfolio, TRY 15,260 Thousand (31 December 2015: TRY 16,211 Thousand) in available for sale securities portfolio and none (31 December 2015: TRY 16,940) in held to maturity portfolio are pledged to the Central Bank and the Istanbul Takas ve Saklama Bankası A.Ş. for regulatory requirements and as a guarantee for stock exchange and money market operations.

6. LOANS AND ADVANCES

| | 31 December 2016 | 31 December 2015 |
|---|---------------------|---------------------|
| Loans and advances to financial institutions | | |
| Financial Institution Originated | | |
| Agence Française de Développement Originated Loans | 13,988 | 20,097 |
| Council of Europe Development Bank Originated Loans | 386,049 | 327,620 |
| World Bank Originated Loans | - | 21,021 |
| Bank Sourced | - | 2,353 |
| Total loans and advances to financial institutions | 400,037 | 371,091 |
| Loans and advances to customers | - | - |
| Financial Institution Originated | | |
| KFW Originated Loans | 75,435 | 21,630 |
| Islamic Development Bank Originated Loans | 512,715 | 230,534 |
| European Investment Bank Originated Loans | 2,042,707 | 1,620,627 |
| Council of Europe Development Bank Originated Loans | 5,563 | 13,977 |
| World Bank Originated Loans | 1,520,449 | 1,060,161 |
| Treasury Loans | - | 287 |
| Development Bank of Japan | 397,788 | 192,609 |
| Bank Sourced | | |
| Investment Loans | 105,339 | 63,524 |
| Personnel Loans | 4,491 | 4,638 |
| Restructured Loans | 78,786 | 47,756 |
| Other Bank Sourced Loans | 206,680 | 224,875 |
| Non-performing Loans | 120,209 | 101,916 |
| Total loans and advances to customers | 5,070,162 | 3,582,534 |
| Less: allowance for losses on loans and advances | (81,109) | (63,358) |
| Total loans and advances to customers, (net) | 4,989,053 | 3,519,176 |

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6. LOANS AND ADVANCES (continued)

Allowance for probable losses on loans and advances include portfolio reserve and specific reserve for loans. 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 2016 | 31 December 2015 |
|-------------------------------|-----------------------------|-----------------------------|
| At the beginning of the year | 63,358 | 62,137 |
| Provision for impairment | 22,197 | 130,421 |
| Recoveries | (4,446) | (129,200) |
| At the end of the year | 81,109 | 63,358 |

7. INVESTMENT IN ASSOCIATES

Istanbul Venture Capital Initiative ("IVCI") was 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 6.2% and 11.1%, respectively (31 December 2015: 6.25% and 11.1%). Capital commitment of IVCI is EUR 160 Million and the Bank's capital commitment is EUR 10 Million. The Bank has made cumulative of EUR 7,155,000 capital payment as at the balance sheet date.

Maksan Malatya Makina Sanayi A.Ş. was established in Malatya, Turkey in 1974 for manufacturing of transformers. The share and voting power of the Bank is 31.14% and 20.0% respectively (31 December, 2015: 31.14% and 20.0%).

Türk Suudi Holding A.Ş. was established in İstanbul, Turkey in order to operate in finance sector. By the 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, 2015: 24.69% and 10%).

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

| | 31 December 2016 | 31 December 2015 |
|--|-----------------------------|-----------------------------|
| Total assets | 466,024 | 328,867 |
| Total liabilities | (10,361) | (10,405) |
| Net Assets | 455,663 | 318,462 |
| Group's share of associates' net assets | 36,071 | 25,586 |

The Group's share of associates' net assets includes net assets of Maksan Malatya Makina Sanayi A.Ş. amounting to TRY 4,802 Thousand (31 December 2015: TRY 4,545 Thousand), net assets of Türk Suudi Holding A.Ş. amounting to TRY 5,300 Thousand (31 December 2015: TRY 4,192 Thousand) and net assets of IVCI amounting to TRY 25,969 Thousand (31 December 2015: TRY 16,849 Thousand).

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7. INVESTMENT IN ASSOCIATES (cont'd)

| | 31 December 2016 | 31 December 2015 |
|---|-----------------------------|-----------------------------|
| Revenue | 91,203 | 42,726 |
| Profit/(loss) for the year | 57,980 | 6,599 |
| Group's share of associates' income / (loss) | 5,116 | 1,016 |

8. PREMISES AND EQUIPMENT

| Current 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 |

* The real estates of our bank have been appraised at the end of 2016 and as a result of the test made according to the new expertise figures, TRY 7.797 Thousand has been reversed in return for the real estates.

| Prior Period (31.12.2015) | Real-Estates | Vehicles | Other | Total |
|--|---------------------|-----------------|--------------|----------------|
| Cost | | | | |
| Balance at the beginning of the period | 111,934 | 130 | 8,854 | 120,918 |
| Movements during the period | | | | |
| -Additions | 19 | - | 1,781 | 1,800 |
| -Disposals (-) | - | - | (956) | (956) |
| Balance at the end of the period | 111,953 | 130 | 9,679 | 121,762 |
| Accumulated Depreciation | | | | |
| Balance at the beginning of the period | 77,089 | 100 | 5,071 | 82,260 |
| Movements during the period | | | | |
| -Depreciation charge | 2,442 | 9 | 1,300 | 3,751 |
| -Disposals (-) | - | - | (957) | (957) |
| Balance at the end of the period | 79,531 | 109 | 5,414 | 85,054 |
| Net book value at the end of the period | 32,422 | 21 | 4,265 | 36,708 |

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9. INVESTMENT PROPERTIES

| | Current Period 31 December 2016 | Prior Period 31 December 2015 |
|--|--|--|
| 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 | 9,054 | 8,688 |
| Movements during the year | | |
| -Depreciation charge | 367 | 366 |
| -Classified from premises and equipment | - | - |
| Balance at the end of the year | 9,421 | 9,054 |
| Net book value at the end of the year | 8,912 | 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 5,386 based on valuations made as at 31 December 2016. The fair value of the Group's investment properties has been arrived at on the basis of valuations carried out by independent valuers that carry valuation licenses 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 507 Thousand (31 December 2015: TRY 355 Thousand).

10. OTHER ASSETS

| | 31 December 2016 | 31 December 2015 |
|-----------------------------------|-----------------------------|-----------------------------|
| Prepaid fees and commissions | 4,819 | 4,471 |
| Sundry debtors | 9,601 | 12,162 |
| Non-current assets to be disposed | 30,419 | 26,332 |
| Other | 1,627 | 1,157 |
| Total | 46,466 | 44,122 |

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11. FUNDS BORROWED

| | 31 December 2016 | 31 December 2015 |
|--------------|-----------------------------|-----------------------------|
| Borrowings | 5,785,105 | 3,959,770 |
| Funds | 15,404 | 14,601 |
| Total | 5,800,509 | 3,974,371 |

| 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 |
| Other borrowings | - | | |
| Total | 5,785,105 | | |

| 31 December 2015 | Amount | Weighted Average Interest Rate | Maturity |
|----------------------------|------------------|---|-----------------|
| USD denominated borrowings | 1,669,801 | 1.45% | 2016- 2036 |
| EUR denominated borrowings | 2,289,969 | 0.68% | 2016- 2036 |
| Other borrowings | - | - | - |
| Total | 3,959,770 | | |

The amounts of funds of the Group as of 31 December 2016 and 2015 are as follows:

| | 31 December 2016 | 31 December 2015 |
|------------------|-----------------------------|-----------------------------|
| Environment fund | 5,159 | 4,787 |
| Incentive fund | - | 289 |
| Other | 10,245 | 9,525 |
| Total | 15,404 | 14,601 |

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.

| | 31 December 2016 | 31 December 2015 |
|---|-----------------------------|-----------------------------|
| Short term borrowings | - | - |
| Short term part of long term borrowings | 366,131 | 211,285 |
| Long term borrowings | 5,418,974 | 3,748,485 |
| Total | 5,785,105 | 3,959,770 |

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11. FUNDS BORROWED (continued)

Repayment plan of borrowings is as follows:

| | 31 December 2016 | | 31 December 2015 | |
|---------------------|------------------|---------------|------------------|---------------|
| | Fixed rate | Floating rate | Fixed rate | Floating rate |
| 2016 | - | - | 266 | 211,019 |
| 2017 and thereafter | 1,641 | 364,489 | - | 3,748,485 |
| 2018 and thereafter | | 5,418,975 | - | - |
| Total | 1,641 | 5,783,464 | 266 | 3,959,504 |

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

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.

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

12. OTHER LIABILITIES AND PROVISIONS

| | 31 December 2016 | 31 December 2015 |
|--------------------------------|---------------------|---------------------|
| Other liabilities | | |
| Payables to public enterprises | 4,027 | 3,724 |
| Unearned revenue | 315 | 750 |
| Other transitory accounts | 2,516 | 581 |
| Import transfer orders | - | 1,454 |
| Taxes and dues payable | 1,261 | 1,262 |
| Subscription fee | 2,243 | 1,765 |
| Blocked currency | 4,218 | 3,936 |
| Lawsuit expenses | 335 | 549 |
| Other (*) | 352,514 | 3,499 |
| | 367,429 | 17,520 |
| Provisions | | |
| Employee benefits | 34,791 | 32,707 |
| | 34,791 | 32,707 |
| Total | 402,220 | 50,227 |

(*)The Bank decided to increase the statutory registered capital to TRY 500,000 Thousand, which is the ceiling of the Bank that is subjected to registered capital system. Capital increase process was started on 26 November 2016 and when the legal procedures are completed the registered capital will be increased to TRY 500,000 Thousand. TRY 340.000 regarding to capital increase is accounted for under other liabilities.

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12. OTHER LIABILITIES AND PROVISIONS (continued)

Employee Termination Benefits

In accordance with existing social legislation, the Bank and its subsidiaries 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 4,092.53 and full TRY 3,541.37 at 31 December 2016 and 2015, 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 2016 and 2015, 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. The annual ceiling has been increased to full TRY 4,426.16 effective 1 January 2017.

Movements in the present value of the defined benefit were as follows:

| | 31 December 2016 | 31 December 2015 |
|--|-----------------------------|-----------------------------|
| Opening defined benefit obligation | 32,472 | 28,581 |
| Service cost | 1,190 | 1,049 |
| Interest cost | 3,476 | 5,561 |
| Actuarial profit/loss | (1,048) | (433) |
| Benefits paid | (1,540) | (2,286) |
| Closing defined benefit obligation, recognized in the balance sheet | 34,550 | 32,472 |
| Unused vacation accruals | 241 | 235 |
| Total | 34,791 | 32,707 |

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13. 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.

Corporate tax is applied on taxable corporate income, which is calculated from the statutory accounting profit by adding back non-deductible expenses, and by deducting dividends received from resident companies, other exempt income and investment incentives utilized.

The effective rates of tax are as follows: 2016: 20% and 2015: 20%. In Turkey, advance tax returns are filed on a quarterly basis. The advance corporate income tax rate is 20% for 2016 (2015: 20%).

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 2016 and 2015 advance income taxes are netted off with the current income tax liability as stated below:

| | 31 December 2016 | 31 December 2015 |
|----------------------|-----------------------------|-----------------------------|
| Income tax liability | 22,433 | 17,647 |
| Advance income taxes | (14,890) | (12,474) |
| | 7,543 | 5,173 |

Major components of income tax expense for the years ended 31 December 2016 and 2015 are:

| | 31 December 2016 | 31 December 2015 |
|---|-----------------------------|-----------------------------|
| Current income tax expense | 22,433 | 17,647 |
| Deferred income tax charge / (benefit) | (788) | 5 |
| Income tax expense reported in the consolidated income statement | 21,645 | 17,652 |

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13. INCOME TAXES (continued)

Reconciliation between tax expense and the accounting profit at the statutory income tax rate of the parent bank for the year ended 31 December 2016 and 2015 are as follows:

| | 31 December 2016 | 31 December 2015 |
|---|---------------------|---------------------|
| Profit before income tax | 103,549 | 84,943 |
| At Turkish statutory income tax rate of 20% (2015: 20%) | 20,710 | 16,989 |
| Disallowed expenses | 13 | 12 |
| Income exempt from taxation | (52) | (120) |
| Other adjustments | 974 | 771 |
| Income tax | 21,645 | 17,652 |

Deferred income tax

Deferred income tax as at 31 December 2016 and 2015 relates to the following:

| | Consolidated Balance Sheet | | Consolidated Income Statement | |
|--|-------------------------------|--------------|----------------------------------|--------------|
| | 2016 | 2015 | 2016 | 2015 |
| Deferred income tax liabilities | | | | |
| Reversal of specific loan provision | 4,454 | 4,531 | 77 | (310) |
| Other | 7 | 37 | 30 | (12) |
| Gross deferred income tax liabilities | 4,461 | 4,568 | 107 | (322) |
| Deferred income tax assets | | | | |
| Employee termination benefits | 6,958 | 6,541 | 419 | 746 |
| Specific provisions for non-performing loans | 1,362 | 1,362 | - | - |
| Other | 125 | 47 | 74 | 92 |
| Gross deferred income tax assets | 8,445 | 7,950 | 493 | 838 |
| Deferred income tax asset / (liability), net | 3,982 | 3,382 | 600 | 516 |
| Deferred income tax credit (charge) recognized in equity | | | 188 | (521) |
| Deferred income tax credit (charge) recognized in income statement, net | | | 788 | (5) |

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13. INCOME TAXES (continued)

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

| | 31 December 2016 | 31 December 2015 |
|--|-----------------------------|-----------------------------|
| Balance at January 1 | 3,382 | 2,866 |
| Deferred income tax credit (charge) recognized in equity | (188) | 521 |
| Deferred income tax credit (charge) recognized in income statement | 788 | (5) |
| Balance at period-end | 3,982 | 3,382 |

14. SHARE CAPITAL

The Bank is subject to registered capital system and the ceiling capital is TRY 500,000 Thousand. The authorized paid-in share capital of the Bank amounted to TRY 160,000 Thousand as of 31 December 2016 and 2015. The Bank's capital consist of 16 Billion shares with a par value of TRY 0,01 each.

| | Share (%) | 31 December 2016 | 31 December 2015 |
|--|------------------|-----------------------------|-----------------------------|
| Paid capital per statutory records | | | |
| - Undersecretariat of Treasury of the Turkish Republic | 99,08 | 158,530 | 158,530 |
| - Other Shareholders | 0,92 | 1,470 | 1,470 |
| | | <u>160,000</u> | <u>160,000</u> |
| Indexation Effect | | 1,290,923 | 1,290,923 |
| Indexed Share Capital | | <u>1,450,923</u> | <u>1,450,923</u> |

The Bank decided to increase the registered capital to TRY 500,000 Thousand, which is the ceiling of the Bank that is subjected to registered capital system. Capital increase process has started on 26 November 2016 and when the legal procedures are completed the registered capital will be increased to TRY 500,000 Thousand.

15. DIVIDENDS PAID AND PROPOSED

In accordance with the decision taken by The General Assembly of the Bank for the year 2015 that was carried out on 22 April 2016, out of the net distributable profit amounting to TRY 62,434 Thousand, which is the remaining profit after deduction of first degree legal reserve is transferred to extraordinary reserves. According to Communiqué of the BRSA dated 8 December 2004 and numbered 2004/3, deferred tax benefit is not considered in profit distribution.

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16. 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 | | | | | Closing |
|-----------------|---|------|----------------------------------|-----------------------------------|-------|------------|
| | Opening | Cash | Transfers from Retained Earnings | Reinvestment of Dividend Payments | Total | |
| 2012 and before | 16,000,000 | - | - | - | - | 16,000,000 |
| 2013 | 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 |

There is no dilution of shares as of 31 December 2016 and 2015.

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

| | 31 December 2016 | 31 December 2015 |
|--|------------------|------------------|
| Net profit / (loss) attributable to ordinary shareholders for basic earnings per share | 81,904 | 67,291 |
| Weighted average number of ordinary shares for basic earnings per share | 16,000,000,000 | 16,000,000,000 |
| Basic earnings per 100 shares | 0.5119 | 0.4206 |

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

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17. 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 Undersecretariat of Treasury of the Turkish Republic. Transactions between the Bank and its subsidiaries, which are related parties of the Bank, have been eliminated on consolidation and are not disclosed in this note.

Transactions with key management personnel:

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

As of 31 December 2016 and 2015 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 2016 | 31 December 2015 |
|------------------------------|-----------------------------|-----------------------------|
| Dividend and fringe benefits | 148 | 143 |
| Total | 148 | 143 |

18. INTEREST INCOME ON SECURITIES

| | 31 December 2016 | 31 December 2015 |
|-------------------------------------|-----------------------------|-----------------------------|
| Available-for-sale financial assets | 10,053 | 8,855 |
| Held to maturity investments | 1,919 | 1,780 |
| Total | 11,972 | 10,635 |

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19. OTHER OPERATING INCOME

| | 31 December 2016 | 31 December 2015 |
|--------------------------------|-----------------------------|-----------------------------|
| Income from sale of properties | 347 | 796 |
| Reversal of other provisions | 8,191 | 1,188 |
| Other | 881 | 700 |
| Total | 9,419 | 2,684 |

20. OTHER OPERATING EXPENSES

| | 31 December 2016 | 31 December 2015 |
|---------------------------------------|-----------------------------|-----------------------------|
| Administrative expenses | 12,306 | 10,391 |
| Staff costs: | | |
| Personnel expenses | 56,909 | 52,593 |
| Retirement pay provision | 4,885 | 6,610 |
| Depreciation and amortization expense | 5,373 | 5,104 |
| Other | 4,547 | 4,243 |
| Total | 84,020 | 78,941 |

21. FEES AND COMMISSIONS INCOME AND EXPENSES

| | 31 December 2016 | 31 December 2015 |
|--------------------------------------|-----------------------------|-----------------------------|
| Fees and commissions income | | |
| Banking | 20,001 | 10,655 |
| Total | 20,001 | 10,655 |
| Fees and commissions expenses | | |
| Banking | (405) | (664) |
| Total | (405) | (664) |

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22. 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 2016 | 31 December 2015 |
|-----------------------------|-----------------------------|-----------------------------|
| Letters of guarantee issued | 38 | 38 |
| Letters of credit | 84,402 | 86,660 |
| Total non-cash loans | 84,440 | 86,698 |
| Other commitments | 10,484 | 12,215 |
| Total | 94,924 | 98,913 |

Transactions Made on Behalf and Account of Others and Fiduciary Transactions

The Bank acts as an intermediary for purchases and sales of securities on behalf of others and provides custody services. Besides, the Bank acts as an intermediary for implementation of tourism and infrastructure investments on behalf of Republic of Turkey Ministry of Culture and Tourism.

The Bank has no fiduciary transactions.

Litigation

In the normal course of its operations, the Group can constantly be faced with legal disputes, claims and complaints. The necessary provision, if any, for those cases are provided based on management estimates and professional advice.

23. 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.

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23. 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 real 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.

Netting is a technique used by the Bank to mitigate counterparty risks on derivative transactions.

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.

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23. FINANCIAL RISK MANAGEMENT (continued)

Credit Risk (continued)

Sectoral breakdown of cash loans is as follows:

| | Cash | |
|--|-----------------------------|-----------------------------|
| | 31 December 2016 | 31 December 2015 |
| Agricultural | - | 8,210 |
| Farming and raising livestock | - | 8,210 |
| Manufacturing | 4,149,205 | 2,887,282 |
| Production | 969,109 | 634,470 |
| Electric, gas and water | 3,180,096 | 2,239,705 |
| Construction | - | 13,107 |
| Services | 1,196,293 | 888,201 |
| Hotel, food and beverage services | 724,859 | 488,527 |
| Financial institutions | 400,037 | 371,091 |
| Education Services | 22,075 | 3,026 |
| Health and social services | 49,322 | 26,803 |
| Other | 4,492 | 66,770 |
| Total loans | 5,349,990 | 3,851,709 |
| Non-performing loans | 120,209 | 101,916 |
| Less: allowance for losses on loans and advances | (81,109) | (63,358) |
| Total | 5,389,090 | 3,890,267 |

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

| Maximum Exposure | 31 December 2016 | 31 December 2015 |
|--|-----------------------------|-----------------------------|
| Deposits with banks and other financial institutions | 1,265,426 | 525,015 |
| Money market placements | 10,505 | 35,010 |
| Balances with the Central Bank | 1,020 | 200 |
| Financial assets available for sale | 193,400 | 164,475 |
| Loans and advances | 5,389,990 | 3,890,267 |
| Investments held to maturity | 20,415 | 20,532 |
| Total | 6,880,756 | 4,635,499 |
| Contingent liabilities | 84,440 | 86,698 |
| Commitments | 10,484 | 12,215 |
| Total | 94,924 | 98,913 |
| Total credit risk exposure | 6,975,680 | 4,734,412 |

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23. FINANCIAL RISK MANAGEMENT (continued)

Credit Risk (continued)

Credit quality per class of financial assets as of 31 December 2016 and 2015:

| 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 | 1,265,426 | - | 1,265,426 |
| Loans | 5,343,838 | 45,252 | 5,389,090 |
| Financial Assets Available for Sale | 185,363 | 8,037 | 193,400 |
| Investments Held to Maturity | 20,415 | - | 20,415 |
| As of 31 December 2015 | Neither past due nor impaired | Past due and individually impaired or past due but not impaired | Total |
| Deposits with banks and other financial institutions | 525,015 | - | 525,015 |
| Loans | 3,848,935 | 41,332 | 3,890,267 |
| Financial Assets Available for Sale | 156,438 | 8,037 | 164,475 |
| Investments Held to Maturity | 20,532 | - | 20,532 |

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23. 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 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 |

| As of 31 December 2015 | Less than 30 Days | Between 31 and 60 Days | Between 61 and 90 Days | Total |
|-------------------------------|--------------------------|-------------------------------|-------------------------------|--------------|
| Loans | | | | |
| Corporate Loans | 1,596 | 218 | 829 | 2,643 |
| Specialized Loans | 101 | - | 77 | 178 |
| Total | 1,697 | 218 | 906 | 2,821 |

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

| Collateral Type | 31 December 2016 | 31 December 2015 |
|---|-------------------------|-------------------------|
| Real estate mortgage (*) | 65,442 | 65,913 |
| Financial collaterals (Cash, securities pledge, etc.) | 214,623 | 133,198 |
| Total | 280,065 | 199,111 |

(*) 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 2016 | 31 December 2015 |
|--------------------------|-------------------------|-------------------------|
| Real estate mortgage (*) | 102,046 | 100,526 |
| Other (**) | 16,916 | 23 |
| Total | 118,962 | 100,549 |

(*) 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.

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23. 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.

Liquidity risk may arise as the most important risk factor when structural problem caused by disbursement of long-term loans using short term borrowings is coupled with a financial crisis. Since the Bank is an investment and development bank and does not accept deposits, unlike the other banks in the system, facing the risk of liquidity crisis due to deposit withdrawals as a result of adverse events in the market is eliminated. 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 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 | (528,007) | 5,800,509 |
| Obligations under repurchase agreements | 351 | - | - | - | - | - | 351 |
| Total | 33,743 | 78,311 | 325,823 | 2,450,824 | 3,440,162 | (528,007) | 5,800,860 |
| As of 31 December 2015 | Up to 1 Month | 1-3 Months | 3-12 Months | 1-5 Years | Over 5 Years | Adjustment | Total |
| Liabilities | | | | | | | |
| Funds borrowed | 19,399 | 54,505 | 193,475 | 1,633,746 | 2,356,343 | (283,100) | 3,974,371 |
| Obligations under repurchase agreements | 226 | - | - | - | - | - | 226 |
| Total | 19,625 | 54,505 | 193,475 | 1,633,746 | 2,356,343 | (283,100) | 3,974,595 |

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23. FINANCIAL RISK MANAGEMENT (continued)

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

| 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 |
|--|----------------|--------------------------|-------------------|------------------------|------------------------------|-------------------------|----------------------|------------------|
| Assets | | | | | | | | |
| Cash and cash equivalents | 357,466 | 857,798 | 50,212 | - | - | - | - | 1,265,476 |
| Balances with Central Bank | 1,020 | - | - | - | - | - | - | 1,020 |
| Money market placements | - | 10,505 | - | - | - | - | - | 10,505 |
| Financial assets at fair value through profit and loss | - | - | - | - | - | - | - | - |
| Investment securities available-for-sale | 8,037 | 19,386 | 9,504 | 45,618 | 110,844 | - | 11 | 193,400 |
| Loans and advances to customers and financial institutions | - | 154,384 | 82,004 | 485,780 | 2,942,707 | 1,685,114 | 39,101 | 5,389,090 |
| Investments securities held to maturity | - | 20,415 | - | - | - | - | - | 20,415 |
| Other assets | - | - | - | - | - | - | 139,187 | 139,401 |
| Total assets | 366,523 | 1,062,488 | 141,720 | 531,398 | 3,053,551 | 1,685,114 | 178,299 | 7,019,093 |
| Liabilities and equity | | | | | | | | |
| Funds provided from other financial institutions | - | 32,695 | 72,759 | 276,057 | 2,197,914 | 3,220,829 | 255 | 5,800,509 |
| Obligations under repurchase agreements | - | 351 | - | - | - | - | - | 351 |
| Other liabilities | 18,114 | 1,309 | 7,496 | - | - | - | 1,191,314 | 1,218,233 |
| Total liabilities and equity | 18,114 | 34,355 | 80,255 | 276,057 | 2,197,914 | 3,220,829 | 1,191,569 | 7,019,093 |
| Liquidity gap | 348,409 | 1,028,133 | 61,465 | 255,341 | 855,637 | (1,535,715) | (1,013,270) | - |
| As of 31 December 2015 | Demand | Up to 1 Month | 1-3 Months | 3-12 Months | 1 year to 5 years | Over 5 years | Undistributed | Total |
| Total assets | 18,178 | 675,268 | 86,984 | 424,308 | 2,169,823 | 1,222,445 | 158,805 | 4,755,811 |
| Total liabilities and equity | 8,680 | 13,816 | 53,507 | 165,223 | 1,499,908 | 2,248,352 | 766,325 | 4,755,811 |
| Liquidity gap | 9,498 | 661,452 | 33,477 | 259,085 | 669,915 | (1,025,907) | (607,520) | - |

(*) 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 and equity are classified as undistributed.

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

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23. 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 2016 | 31 December 2015 | 31 December 2016 | 31 December 2015 |
| USD | 10 increase | 315 | 509 | (254) | (50) |
| USD | 10 decrease | (315) | (509) | 254 | 50 |
| EURO | 10 increase | 2,939 | 2,156 | (672) | (14) |
| EURO | 10 decrease | (2,939) | (2,156) | 672 | 14 |
| Other | 10 increase | 26 | 23 | - | - |
| Other | 10 decrease | (26) | (23) | - | - |

(*) Indicates the values before tax.

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23. 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 2016 | | | | |
| Assets | | | | |
| Due from other banks and financial institutions | 331,562 | 221,556 | 259 | 553,377 |
| Investment securities available-for-sale | 49,164 | 38,376 | - | 87,540 |
| Loans and advances to customers and financial institutions | 2,946,419 | 2,216,530 | - | 5,162,949 |
| Investments in associates | 25,969 | - | - | 25,969 |
| Other assets | 373 | 1,183 | - | 1,556 |
| Total assets | 3,353,487 | 2,477,645 | 259 | 5,831,391 |
| Liabilities | | | | |
| Funds provided from other financial institutions | 3,319,408 | 2,465,697 | - | 5,785,105 |
| Miscellaneous liabilities | 3,305 | 8,384 | - | 11,689 |
| Other liabilities | 1,385 | 412 | - | 1,797 |
| Total liabilities | 3,324,098 | 2,474,493 | - | 5,798,591 |
| 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 |
| As of 31 December 2015 | | | | |
| Total assets | 2,426,195 | 1,567,563 | 233 | 3,993,991 |
| Total liabilities | 2,404,639 | 1,562,473 | - | 3,967,025 |
| Net on balance sheet position | 21,556 | 5,090 | 233 | 26,879 |
| Net off balance sheet position | - | - | - | - |
| Non-cash loans | 84,160 | 2,500 | - | 86,660 |

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23. FINANCIAL RISK MANAGEMENT (continued)

Interest Rate Risk

The Bank's basic principle in the interest rate risk management policy is to consider mismatch between loans disbursed with fixed and floating rate and funds provided with fixed and floating rate. Accordingly, interest rate, currency and maturity mismatch is considered in evaluating 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.

Interest rate risk on banking book

Bank calculates the interest rate risk on banking book according to "Regulation on Measurement and Evaluation of Interest Rate Risk on Banking Book as per Standard Shock Method" and reports to the BRSA monthly.

Interest Rate Risk on Banking Book report includes Receivables from Central Bank, Money Market Placements, Receivables from Banks, Available for Sale Financial Assets (excluding government bonds), Receivables from Reverse-repo, Loans and Receivables, Investments Held to Maturity and Other Receivables in the asset side, and Payables to Central Bank, Money Market Borrowings, Payables to Banks, Repos, Issued Bonds; Borrowings, Subordinated Debt and Other Payables on the liabilities side.

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23. FINANCIAL RISK MANAGEMENT (continued)

Interest rate risk on banking book (continued):

Economic value differences due to the interest rate instabilities calculated according to “Regulation on Measurement and Evaluation of Interest Rate Risk on Banking Book as per Standard Shock Method” are presented below for each currency.

As of 31 December 2016:

| | Type of Currency | Shocks Applied (+/- x basis points) | Gains / Losses | Gains / Equity – Losses / Equity |
|---|-----------------------------------|--|-----------------|-------------------------------------|
| 1 | TRY | (+) 500 | (9.535) | % (1,18) |
| 2 | TRY | (-) 400 | 9.269 | % 1,15 |
| 3 | EUR | (+) 200 | 17.641 | % 2,19 |
| 4 | EUR | (-) 200 | (20.906) | % (2,60) |
| 5 | USD | (+) 200 | 14.022 | % 1,74 |
| 6 | USD | (-) 200 | (16.008) | % (1,99) |
| | Total (of negative shocks) | | (27.645) | % (3,43) |
| | Total (of positive shocks) | | 22.128 | % 2,75 |

As of 31 December 2015:

| | Type of Currency | Shocks Applied (+/- x basis points) | Gains / Losses | Gains / Equity – Losses / Equity |
|---|-----------------------------------|--|----------------|-------------------------------------|
| 1 | TRY | (+) 500 | (6.692) | % (0.92) |
| 2 | TRY | (-) 400 | 6,178 | % 0.85 |
| 3 | EUR | (+) 200 | 5,120 | % 0.70 |
| 4 | EUR | (-) 200 | (5,891) | % (0.81) |
| 5 | USD | (+) 200 | 4,489 | % 0.62 |
| 6 | USD | (-) 200 | (5,516) | % (0.76) |
| | Total (of negative shocks) | | (5,229) | % (0.72) |
| | Total (of positive shocks) | | 2,917 | % 0.40 |

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23. FINANCIAL RISK MANAGEMENT (continued)

Interest rate sensitivity based on repricing dates:

| 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 |
|--|----------------------|----------------------|-----------------------|--------------------------|---------------------|-----------------------------|------------------|
| Assets | | | | | | | |
| Cash and cash equivalents | 857,798 | 50,212 | - | - | - | 357,466 | 1,265,476 |
| Balances with Central Bank | - | - | - | - | - | 1,020 | 1,020 |
| Money market placements | 10,505 | - | - | - | - | - | 10,505 |
| Financial assets at fair value through profit and loss | - | - | - | - | - | - | - |
| Investment securities available-for-sale | 32,281 | 9,265 | 36,665 | 107,141 | - | 8,048 | 193,400 |
| Loans and advances to customers and financial institutions | 1,531,685 | 895,522 | 1,727,471 | 59,831 | 1,135,480 | 39,101 | 5,389,090 |
| Investment securities held to maturity | 20,415 | - | - | - | - | - | 20,415 |
| Other assets | - | - | - | - | - | 139,187 | 139,187 |
| Total assets | 2,452,684 | 954,999 | 1,764,136 | 166,972 | 1,135,480 | 544,822 | 7,019,093 |
| Liabilities and equity | | | | | | | |
| Obligations under repurchase agreements | 351 | - | - | - | - | - | 351 |
| Funds provided from other financial institutions | 873,012 | 1,122,836 | 2,526,098 | 590,277 | 688,286 | - | 5,800,509 |
| Other liabilities | - | - | - | - | - | 1,218,233 | 1,218,233 |
| Total liabilities and equity | 873,363 | 1,122,836 | 2,526,098 | 590,277 | 688,286 | 1,218,233 | 7,019,093 |
| On balance sheet interest sensitivity gap – Long | 1,579,321 | - | - | - | 447,194 | - | 2,026,515 |
| On balance sheet interest sensitivity gap – Short | - | (167,837) | (761,962) | (423,305) | - | (673,411) | (2,026,515) |
| Off balance sheet interest sensitivity gap – Long | - | - | - | - | - | - | - |
| Off balance sheet interest sensitivity gap – Short | - | - | - | - | - | - | - |
| Total position | 1,579,321 | (167,837) | (761,962) | (423,305) | 447,194 | (673,411) | - |
| As of 31 December 2015 | 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 | 2,034,708 | 651,828 | 1,341,784 | 106,514 | 443,994 | 176,983 | 4,755,811 |
| Total liabilities and equity | 1,071,272 | 817,832 | 2,048,625 | 18,032 | 18,836 | 781,215 | 4,755,811 |
| Total position | 963,436 | (166,004) | (706,841) | 88,482 | 425,158 | (604,231) | - |

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23. 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% (12% if a bank operates in offshore markets). 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 2016, its capital adequacy ratio on an unconsolidated basis is 13.41% (31 December 2015: 17.84%).

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.

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23. FINANCIAL RISK MANAGEMENT (continued)

Fair Value of financial instruments

The Group considers that the carrying amounts of financial assets and financial liabilities recorded in the financial statements approximate their fair values.

| | Carrying amount | | Fair value | |
|---|---------------------|---------------------|---------------------|---------------------|
| | 31 December 2016 | 31 December 2015 | 31 December 2016 | 31 December 2015 |
| Financial assets | | | | |
| Loans and advances | 5,389,090 | 3,890,267 | 5,423,363 | 3,914,552 |
| Investment securities available-for-sale | 193,400 | 164,475 | 193,400 | 164,475 |
| Investment securities held- to-maturity | 20,415 | 20,532 | 20,407 | 20,345 |
| | 5,602,905 | 4,075,274 | 5,637,170 | 4,099,372 |
| Financial liabilities | | | | |
| Funds Provided from Other Financial Institutions | 5,800,509 | 3,974,369 | 5,814,907 | 4,013,116 |
| Sundry Creditors | 18,114 | 8,680 | 18,114 | 8,680 |
| | 5,818,623 | 3,983,049 | 5,833,021 | 4,021,796 |

(*) 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. The fair value of derivative instruments, are calculated using quoted prices. Where such prices are not available, estimate is made based on 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.

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23. FINANCIAL RISK MANAGEMENT (continued)

Fair Value of financial instruments (continued)

| 31 December 2016 | Level 1 | Level 2 | Level 3 | Total |
|---|----------------|---------|---------|-------|
| Financial assets at fair value through profit and loss | - | - | - | - |
| Debt securities | - | - | - | - |
| Derivative financial assets held-for-trading | - | - | - | - |
| Financial assets available-for-sale (*) | 185,352 | - | - | - |
| Debt securities | 185,352 | - | - | - |
| Other | - | - | - | - |
| Investment in subsidiaries and associates (**) | - | - | - | - |
| Derivative financial liabilities | - | - | - | - |

(*) 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.

(**) Since the unlisted investments in associates are recognized at acquisition cost within the framework of IAS 39, these companies are not included in the table.

| 31 December 2015 | Level 1 | Level 2 | Level 3 | Total |
|---|----------------|---------|---------|-------|
| Financial assets at fair value through profit and loss | - | - | - | - |
| Debt securities | - | - | - | - |
| Derivative financial assets held-for-trading | - | - | - | - |
| Financial assets available-for-sale (*) | 156,431 | - | - | - |
| Debt securities | 156,431 | - | - | - |
| Other | - | - | - | - |
| Investment in subsidiaries and associates (**) | - | - | - | - |
| Derivative financial liabilities | - | - | - | - |

(*) 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.

(**) Since the unlisted investments in associates are recognized at acquisition cost within the framework of IAS 39, these companies are not included in the table.

In the current period, there is no transition between Level 1 and Level 2.

24. SUBSEQUENT EVENTS

None.