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«Profitability as a tool for performance appraisal of an organization»

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ABSTRACT

In this assignment, I will investigate how profitability affect the performance of the company. In order to get the extensive knowledge required for the assignment, the study will be used with the annual reports of some commercial banks. The using reports are consolidated audited financial statement. By analyzing those statements the thesis aims to have an understanding of exactly how profitability ratios- gross profit margin, operating profit margin, net profit margin, cash flow margin, EBIT, EBITDA Return on Assets (ROA), Return on Equity (ROE), Return on Capital Employed (RCE), cash return on assets, return on debt, return on retained earnings, return on revenue, sales and asset size can relate with performance appraisal. Moreover, this research attempts to clarify the importance of performance appraisal from different aspects and investigate different theories one by one. The thesis supports the performance appraisal conception, so that it is one of the most essential factor for investors to search in every company. In addition, it is crucial for internal users of an organization. Using data of 2016, this thesis investigated performance of PASHA Bank. The performance of the bank has been determined by product of profitability. The profitability has been assessed by exploring profitability ratios.

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ABBREVIATIONS

BARS: Behaviorally Anchored Rating Scales

BCC: Banker, Charnes and Cooper

BSC: Balance Score Card

CAMEL: Capital Adequacy, Asset Quality, Management, Earnings and Liquidity

CCR: Charnes, Cooper and Rhodes

CIPD - Chartered Institute of Personnel and Development

CRA: Civil Rights Act

DEA: Data Envelopment Analysis

HR: Human Resources

HRM: Human Resource Management

FS: Financial Statements

FA: Financial Analysis

IAS: International Accounting Standards

GPM: Gross Profit Margin

KPIs: Key Performance Indicators

OPM: Operating Profit Margin

PM: Performance Management

PMP: Performance Management Process

PMS: Performance Management System

ROA: Return on Asset

ROE: Return on Equity

CHAPTER 1.
INTRODUCTION

Performance measurement of an organization has become an essential tool for assessing the successfulness of a company. Performance measurement in the pragmatic and hypothetical spheres has attracted growing consideration in recent years. Especially, in today's speedy economic situation pushes every company to assess its performances properly. Almost all companies- both private and public sectors execute performance measurement to evaluate whether the organization has been managing on the right track, or performance of the company needs to be improved. Performance measurements are used to assess past results in order to make up business targets for the further financial periods. At a previous time, performance measurements were done in a simple way, so that; it was done by comparing financial budget and its realization. Over time, this traditional pattern of measurement has been replaced in different tools. Today, in order to survive organizations are taking steps to increase in size and operation by accessing new markets; making product and price of items more alluring; satisfying customers and covering their needs; developing new unique strategies. That is the reason, managers, and executives of the companies trying to find suitable tools and techniques in order to predict and assess organizational performance, as well to ensure competitive advantage of an organization. However, still, traditional paradigm works well. In the technology age, Key Performance Indicators are frequently used for performance measurement in organizations. However, we cannot say that it is a single best way of evaluating business performance as it is mentioned before in this chapter. In order to check the progress and improve business performance in a competitive way, various management tools are required by organizations besides KPIs. The objective of preparing the financial statements of a company is to express data on the overall performance for the all interested parties. Besides, users of financial statements in such a way can make a decision about financial strengths and weaknesses of the organization. Ratio analysis is one of the ways through which the financial statements could be explained. Especially, profitability is the main performance indicator for determining the successfulness of management strategy of an organization. In addition, ratio analysis is a mode used by financial managers and investors to compare a company’s financial structure, conditions, and performances with standards. In some literature ratio analysis defined as the systematic outputs of ratios. Therefore, these ratios summarize key relationships and results in order to appraise financial performance.

1.1 Statement of the Problem

The managerial choice is one of the keys making the organization successful. Moreover, it is undeniable that, management makes a decision based on financial conditions of an organization. In such decisions, the management especially focuses on two basics of comparison:

1. Current particular data are compared with the data of previous years in the organization at least five (5) years period.
2. Current data are compared with the data of other similar organizations.

Because of this commonly used action, calculable shortcomings may arise which could force management to make serious decisions that could destroy the organization. In addition, problems may appear when an attempt is made to differentiate the ratio of a business with those of other organization, and these could derive because of various accounting basis. In addition, effects of inflation-based problems are always being ignored and this ignorance essential limitation for performance measurement using. As a result of the aforementioned should be examined this research.

1.2 Research objective

The relation between perpetual improvement and KPI’s is described in Figure 1. In order to continually improve, the organizational performance needs to be run effectively by making the right decisions. In order to make the right decisions, organizations require measuring their performance, which will bring them the necessary input. The widely accepted tool to measure performance is Key Performance Indicators.

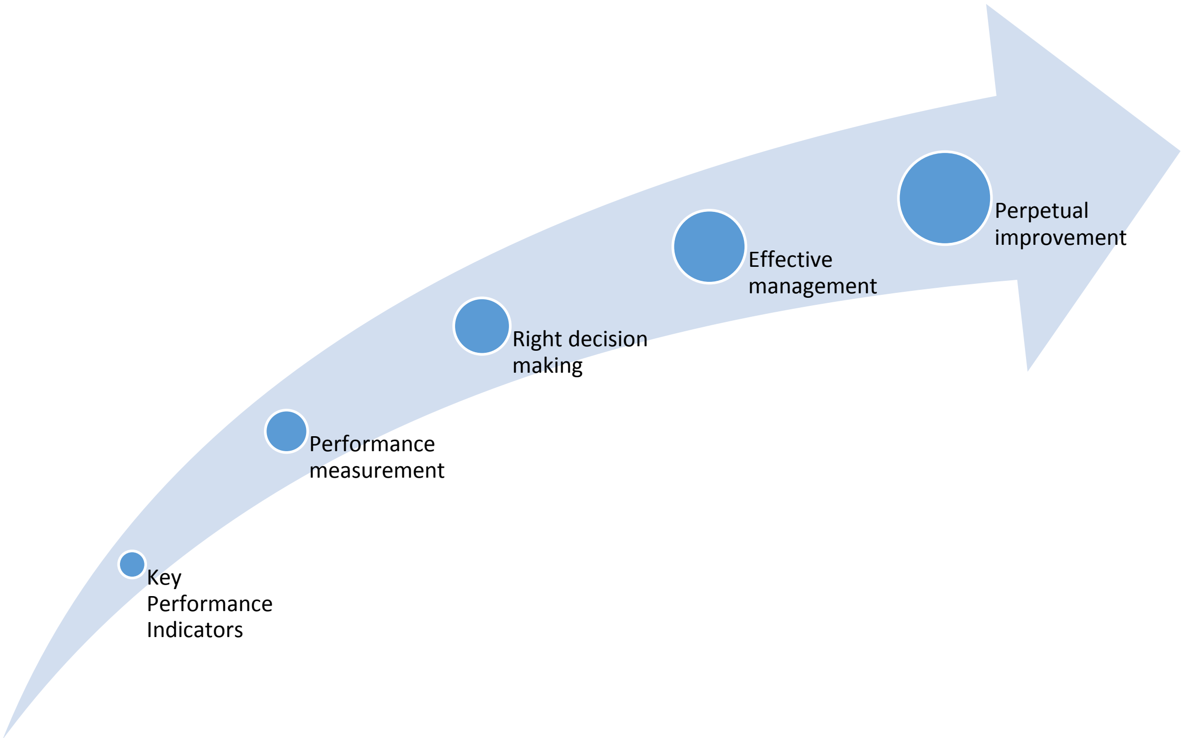

Figure 1.

From the project context and the descriptions, which are mentioned above the broad objective of the thesis, is to examine how ratio analysis can be used to measure the performance of an organization. In addition, the following specific objectives will be examined in the course of this study:

a) To critically examine the financial statement and assess the performance of the enterprise through ratios to find out whether resources are utilized effectively and efficiently.

b) To analyze the problems related to the use of financial ratios and offer possible solutions for them.

c) To identify the necessity of financial ratio analysis to every user group.

1.3 Research Questions

The given research questions will be examined during this study:

1. Why do organizations need to measure their performance?
2. What are Key Performance Indicators?
3. What are the Key Performance Indicators that Company Management needs to use in order to evaluate the company Performance?
4. Does ratio analysis help management in taking effective decisions?

CHAPTER 2.
LITERATURE REVIEW

In the previous chapter, we outlined the research and described the context. This chapter (Chapter 2.) investigates existing literature, focusing on performance. This chapter starts by defining performance and analyzing some of its key features from the existing literature. Figure 2 describes the structure and content of literature chapter.

Throughout this chapter, I will look at the Performance Management from its starting point, where it originated, where it is today and how it has become into a necessary management tool over time. We will also look at the most essential features of the performance appraisal system. In addition, we will investigate what elements are important in implementing a successful appraisal structure.

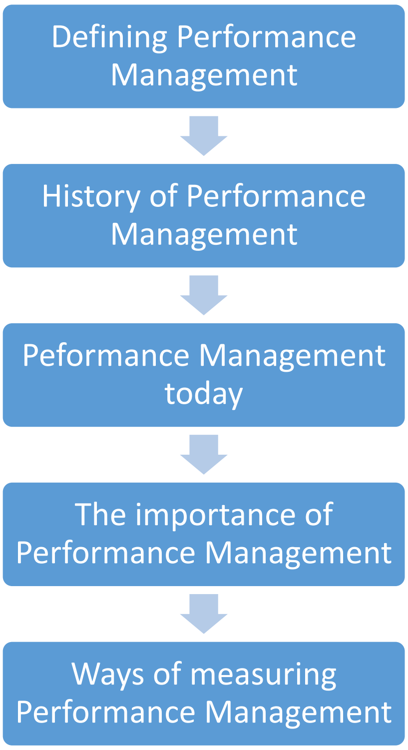

Figure 2.

2.1 Definition of Performance Management

This section defines performance management in general. First, I would like to define the word “performance”. The dictionary definition of performance is as follows:

1. *“The process or act of carrying out or performing”*
2. *“An achievement of person under test conditions”*
3. *“The fulfilment or execution (of a duty) etc.”*

4. "The return on an investment, esp. in stocks and shares etc." [1]

The explanation alludes to some type of attainment by using words such as 'fulfilment' and 'achievement'.

Performance management, is defined by

"An integrated and strategic approach to delivering maintained success to firms by developing the performance of the individuals who work in them and by improving the capabilities of individual contributors and teams". [2]

Most people think that the human resource department of the company should execute performance management process. However, Foot & Hook (2011, 250) think that it is the process which has to be shared between managers, teams and individuals. As Foot& Hook, I think the term should not be thought only as a tool for checking and disciplining employees. It should be considered as a tool for the company to achieve the effectiveness.

In addition, performance may be explained as the reflection of the resources of an organization (or bank) are used in the form that empowers it to achieve its objectives.

According to Rutagi, (1997) financial performance of an organization is how well an organization is performing. Some researchers, also Namisi, (2002), define performance of an organization as the degree to which a company achieves its intended outcome. The general belief among both investigators and practitioners is that effective managers lead to effective organization. Epstein et al., (2003), thinks that, effective managers can be able to add value to the company, both in internal and external benefits. In this case, he considered internal benefit as a long-term profitability, external benefit as a shareholder perspective.

[1] Thompson Ed.1995 (p1015)
[2] Armstrong & Baron (2000, 7)

2.2 History of Performance Management

As many conception, Performance Management is also appeared in China, in the third century during WEI Dynasty was in control (Eichel and Bender, 1984). Performance Management was seen later, in 1648, in Dublin Evening Post when it was declared that the Evening Post assessed legislators using a ranking scale based on personal qualities.[3]

Afterwards, in accordance with McMahon (2009) in the sixteenth century, a 'system for formally rating members of the Jesuit religious order' was used by Ignatius Loyola. Before World War I, McMahon discusses how performance management became public through the scientific school of management. Frederick Taylor governed this school. According to the footsteps of Taylor and his usage of performance management, American pioneer WD Scott evaluated workers abilities in industry and Taylor inspired that. Scott created the "'man to man comparison scale"[4].

Performance Management then became a stricter and widely used process, when a General in the Army of US submitted an evaluation of his soldiers of the War Department. This scale was shortly to be employed to rank US army officers. The General of the Army used a global ranking, which defined his soldiers as for instance ‘a good-natured man’ or ‘a knave despised by all’[5].

Some researchers tell how it is undefined when the initiation of proper reviewing of performance achievement came into effect. In the 1920s US officers who are in the army services were ranked, this quickly followed suit into both US and UK companies Merit ranking came into effect approximately in the 1950s and 1960s both in the US and UK. This became acknowledged as a performance management soon. The first recorded Performance Management in industry was by Robert Owen in New Lanark Mills, Scotland around 1800. He used such an interesting things as character books and blocks for rating staff. The character book

[3] Hackett, cited in Wiese and Buckley, 1998
[4] Armstrong and Baron, 1998 29-30
[5] Bellows and Estep, 1954

documented each employees' daily report. The blocks were colored variously on every side to perform an evaluation of the worker, ranking them from active, strong to passive, weak. Then, he put these blocks into workplace of workers. R.Owen was happy with the system that he improved, also he experimented that blocks raised the workers behavior.[6]

During the 1960s and 1970s, execution by the setting of goals came into effectiveness level. In the 1970s, finally, 'Performance Management' was used as a term first time. "Performance Management became a broadly used management tool in companies around the 1980's. Modern uses of Performance Management had previously been restricted to Army Officers and Senior Management"[7].

After the success of the performance evaluation system used in the Armed Forces, management of big US corporations wanted to check this technique within their organizations, so that hired most of these people who were attended the practice in the Army. The tools for ranking evolved over time. This significant management tool could list workers regardless of their skills and duties.[8]

This tool was improved and brought new methods and choices. These methods were advanced and substantive rather than previous approaches, but their complexity meant that society was not be ready to use in today's world[9].

The popularity of performance management system in an industry was rapidly growing and in the early 1950s, 61 per cent of organizations carried out performance evaluations frequently, compared to 1940s only 15%.[10]

The BARS were created by Smith and Kendall in 1963. It was more superior than alternative methods of evaluation similar to this. BARS replaced numerical or adjective rankings used in the trait or graphic ranking scales, with behavioral examples of actual work behaviors. BARS allowed supervisors to rate employees on observable behavioral elements, rather than on a certain scale. In this type of

[6] Cardy & Dobbins 1994
[7] Taylor 2005, p291
[8] Wiese & Buckley, 199
[9] Flanagan, 1954
[10] Spriegel, 1962

PM method, the evaluator or manager whoever evaluates performance of employees has to make less outcomes about person, because the manager or evaluator is positioned more in the role of observer and fewer in the role of judge. It is considered major benefit of such type measures.[11]

Various alternatives to BARS have been developed. The contribution of these particular developments has been an emphasis on the behavioral bases of performance rankings.[12]

One of the most important events in the development of performance management was the legal requirements, which changed how assessments could carried out. The enactment of the CRA in 1964, in the United States, which forbade administrative action based on skin color of people, sex, religious beliefs, etc., led to a public use for Performance Management. This legal restriction was the last blow to approaches, which were subjective and trait-based.[13]

The links between PMS and HR consequences had become severely regulated.

2.3 Performance Management Today

Performance Management still plays an essential role in organisations today. In 2009, a CIPD report found that 81.3% of surveyed companies were carrying out performance evaluation in their organisation as part of their PMS.

In recent years, performance assessments have been used in companies for different reasons, as opposed to the previous historical method it was utilized for, making managerial decisions. After long survey, which was carried out by Cleveland, Murphy & Williams, four important uses for PMS in organizations were founded, in 1989. These four uses are:

1. Between Individual Comparisons
2. Within Individuals Comparisons

[11] Schwab, Heneman, & DeCotiis, 1975
[12] Wiese & Buckley, 1998, p241
[13] Banner &Cooke, 1984

3. Systems Maintenance
4. Documentation.

Between Individuals Comparisons in terms of performance, also, Within Individuals Comparison focuses on identifying and improving strengths and weaknesses of individuals. Systems Maintenance means using Performance Management System as a source to connect procedures and strategy of company with the performance of staff and the objectives that they have achieved or are working toward. Linking Performance Management to the business objectives of the organization has been seen as an original and innovative way of concentrating employees' actions and behaviors to the priorities of the company. The goal of Documentation is the use of PM to record or justify personnel decisions, also ensure that they are really meeting legal requirements.[14]

After tons of journal articles were read, researches were carried out about PMS, then it was founded that performance evaluation seems like a significant tool and should bring huge amount of benefit to every organization. Lawler believes that Performance Evaluation is an essential procedure for successful talent management.

'The key is to make them part of a complete performance management system, which includes goal setting, development, compensation actions, performance feedback and a goals-based appraisal of performance'[15]

2.4 The Importance of Performance Management

As we know, the goal of every company is to maximize its profit. That is undeniable rule for every organization. Performance Management is one of the ways, which helps company to achieve effectiveness and profitability. Managing employees' performance can rise a company's competitiveness and maximize

[14] Cleveland et al, 1989; Wiese & Buckley, 1998
[15] Lawler, 2012

productivity. Performance Management not only helps maximizing profit, but also assists to increase mood of staff and create strong teams which brings success to company. Following list is about importance of performance management:

1. Higher Productivity
2. Employee Progress
3. High Quality Products & Services
4. Correct Actions

Higher Productivity

PMSs are designed to control employees and organizations running at their maximum level. Regularly evaluated and trained employees know their responsibilities, job duties and they are the right fit for their jobs. Employees, who want to promote, make an excellent career try to be more productive in competitive labour market. This action in turn affects to company and rises productivity.

Employee Progress

PMSs help HR personnel and department managers identify top-rated employees and improve them for the next stage in their careers. In opposite case, without a process to identify high performers, talented employees can become repulsive, stop their proper improvement in this particular job, and end up quitting as a result. In addition, coaching for improved production is a major part of PM and can help individuals overcome their shortcomings, so that, they can progress in their careers and make their organization stronger.

High Quality Products & Services

Properly trained, coached and screened employees are willing to create high-quality products and services. The reason of this is that they have proper skills, understand their responsibilities, and care about organization, about their jobs. At the same time these employees looking for new and innovative ideas to remove waste related to work. The companies, which have good PMS, keep delays, excess transportation, rework, and overproduction at a minimum level.

Correct Actions

PMSs have corrective action procedures that can help staff correct deficient behaviour in a professional and quick manner. Employers and managers have "defined guidelines for employee termination". These guidelines makes it easier for managers to obey the law in case of terminating an employee. Corrective action's system steps can make it easy for employers and managers to modify their training techniques to lead their personnel better, too.

2.5 Ways of measuring Performance Management

Importance of PM is mentioned repeatedly in previous chapters. Being aware of how the different spheres of business are performing is beneficial information in its own right; however, a good evaluation system will also allow you to examine any changes in performance. PM puts business in a superior position to manage its performance actively.

One of the fundamental challenges with PM is selecting what to assess. The focus should be quantifiable components that are directly connected to the factors that are related to success in business and sector. This success related factors are known as KPIs. Key performance indicators are at the heart of performance measurement system and target setting. They are one of the strongest management tools that push business to growth, when they properly used. Many KPIs are known but the company does not need use all of them. Depending on company, and its industry, its KPIs should meet a number of important criteria.

1. KPIs should meet with the goals of company.
2. KPIs need to be quantifiable.

3. KPIs should relate to features of the business environment, which it has some control.

As aforementioned, the goal of every company is to maximize its profit, so measuring profitability is important for all of them. Profitability ratios include:

a) Gross profit margin,
b) Operating profit margin,
c) Net profit margin,
d) Cash flow margin,
e) EBIT,
f) EBITDA
g) Return on Assets,
h) Return on Equity,
i) Return on Capital Employed, etc.

We will define all of these ratios detailed on next chapters.

Why is improving your (KPIs) so important for business?

Because company needs to track its performance in order to develop it.

2.6 Performance appraisal and performance management

Most of today's literature we can find that Performance Appraisal should be carried out as a part of Performance Management System. Walters expressed PM as the 'it is a process that directs and supports employees to work effectively and efficiently according to organizational goals'.[16]

Williams thinks the main assumption of Performance Management is creating a joint vision of the targets and purpose of the organization, helping each employee to understand and recognize their part in assisting to them, and regularly controlling and improving the performance of individuals and the organization.[17]

[16] Walters (1995)
[17] William, 2002

Performance Appraisal plays a key role in PMSs; it is typically as a vehicle behind which the organizational objectives and goals are translated into an each employee's objective. It remains the primary method of discussing and acting on the improvement process of the individual. [18]

As a part of Performance Management, Performance Appraisal has much more tight relationship with large business environment. De Nisi and Griffen think that PM refers to 'an accepted set of activities which are executed by the organization to improve employee performance'. Performance Management based on typical Performance Appraisal activities, however Performance Appraisal is a part of Performance Management Process and PM is much broader and encompassing process.[19]

Fletcher and Williams state that Performance Management brings more success and benefit to an organization. So that, they carried out a study in 1996. Results of this study showed that characteristics of PM cause organizational commitment and job satisfaction in nine UK organizations.

According to Lawler, Benson & McDermott PMSs that are more effective based on jointly decided goals, which accepted for driving business to a better point.

2.7 Concepts of Performance Management with Respect to Performance Measurement

During my investigation process, I reviewed literatures and I found that there is a lack of theoretical clarity regarding the terms both "performance management" and "performance measurement". Radnor and McGuire stated that, even some literatures does not distinguish these two "different" terms.

Radnor and Lovell express PMSs by using the term "it is the combination of both performance management and performance measurement".

[18] Fletcher, 2004
[19] De Nisi & Griffen, 2008, p.318

This thought suggests an overlap in the literature between the two conceptually vague terms. However, some researchers use existing literatures for distinguishing and defining these terms, separately. The management concepts, which are analyzed above, suggest that PM involves planning and controlling performance. For instance, Bourne define how organizations are focusing upon managing performance development and drivers of performance day by day, as well as evaluating performance.

Further, Kaplan and Norton investigated and suggested the use of the BSC as a part of strategic management system. In addition, they suggested working with original BSC paper, and it was defined from a performance evaluation point of view. This particular concept of PM, which was suggested, by Norton and Kaplan found widely because of included some sort of planning and controlling.[20]

Halachmi expresses PM as: "… it is a more meaningful and broader concept than simple performance measurement". Then he added, "Because listing processes indicative of broader PM such as catering to stakeholders, attending to human behavioral factors and handling problems in the environment. [21]

Bititci describes performance management as a: "process that allows an organization to handle its performance according to its strategy and objectives."[22]

Bourne describe that "although past researches focused on choice and realization of performance measures, future researches must look at how performance evaluations are used in PM processes.[23]

Agreeing, O'Neill thinks a PMS as using performance measures to decide whether performance improvements are happen or not.[24]

Performance Measures	**Performance Management**

[20] Norton and Kaplan 1996
[21] Halachmi 2005
[22] Bititci et al. 1997
[23] Bourne et al. 2005
[24] O'Neill 2006

Measures based on key success factors Measures for detection of deviations Measures to track past achievements Measures to describe the status potential Measures of output Measures of input	Training Team work Dialogue Management style Attitudes Shared vision SPC Employee involvement Multicompetence TQC Incentives, rewards

Table 1.

Lebas (1995) makes an infrequent attempt to distinguish performance management and performance measurement from one another. Therefore, that, descriptions given in Table 1 do not concentrate on both concepts as actions. Lebas suggests that PM anticipated performance assessment, that these two concepts are complementary, and yet they cannot be separated. This formulation, which is suggested by Lebas, reflects some aspects of the publications by graphically demonstrating PM as broader than performance evaluation. Research has emphasized that performance measurement solely cannot change performance, although control action and planning based on performance measurement can.[25]

The impacts of performance management and performance measurement processes on performance are discussed later.

[25] Halachmi 2005, Hume & Wright 2006

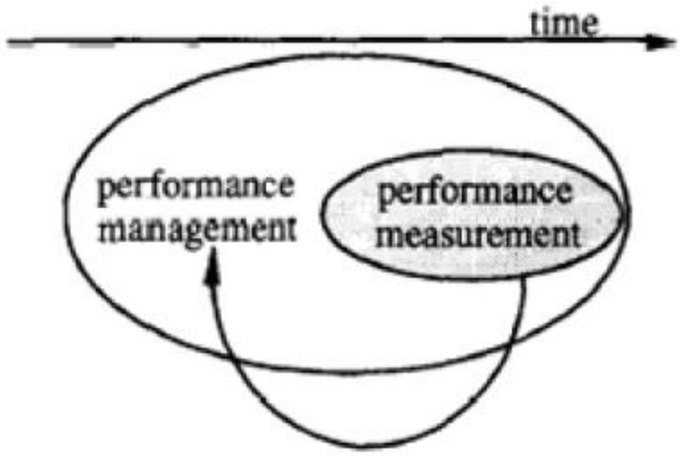

Figure 2.1

The performance literature includes a number of control and planning processes, which are broader than performance measurement, so can be considered PMPs. The literature emphasizes that the different types of network between interacting individuals and organizations underpin PMPs.

CHAPTER 3.

METHODOLOGY

This chapter focuses on information about banking system of Republic of Azerbaijan and methodology of this thesis. The banking system of Azerbaijan is essential part of financial system. Banking system represents the combination various interrelated banks and different credit institution, which are existing under sole financial mechanism. So that, in two-tier banking system, there are two levels and Central bank is in the first level, and commercial banks, state-owned banks, and credit organizations are on the second level. The central bank is of Azerbaijan and demonstrates the upper level of the system. Central bank is performing the relationship with banks that are in other countries, other financial institution and international banks; however, it is non-profit organization. As mentioned above, the research aims to assess the efficiency and profitability level of PASHA Bank. The research uses financial data of the PASHA bank for t2016 accounting period. The common expectation is that the profitable financial performance of an enterprise resource reflects a high level of profitability. In this study we will measure profitability with commonly used tools such as ROA and ROE. The thesis contains of seven chapters.

CHAPTER 4.

PERFORMANCE MEASUREMENT

4.1 Evaluating the performance of a Bank

Effectiveness of the banking sector is an undoubtedly important issue for both transition economies and developed economies. There are a number of studies to measure and assess the overall performance of the banking sector in terms of both profitability and efficiency. In the past, both developed and developing transition countries have been experiencing banking crises at different times, affecting economic growth. For instance; Chile, Mexico and Argentina in 1980s; Sweden in 1990s; Malaysia, Thailand, Philippines, Indonesia, and Korea, Paraguay, Russia at the end of 1990s; Turkey in 1994, and at the beginning of millennium; Argentina in 2001. The financial sector plays a very important role in the economic growth of a country. For this reason, the efficiency and profitability of the banking sector has been associated with the development of economies. In keeping with the objective of the thesis, the review of the literature will focus on the profitability and productivity of the banking sector in terms of performance determination.

4.2 Efficiency of the Banking Sector

Efficiency is one of the basic terms used to evaluate and measure the performance of institutions. Efficiency is about reducing the cost to the least, and it deals with the distribution of assets according to the best alternative uses. Efficiency specifies the level of output obtained by a certain amount of input, such as cost per unit. A more efficient unit means a higher output level using the same amount of input, or an output at the same level using a less input level. A productive bank can be defined as a unit that can create relatively high income-generating assets and liabilities; this is the same as the ability to create a relatively high level of income from service and mediation activities with given input levels. Efficiency analysis is crucial for the measurement process of bank performance. There are several tools to assess efficiency. For instance, Stochastic Cost Frontier, Data Envelopment Analysis CAMEL. Most analysts broadly used DEA approach for measuring efficiency of banks. The DEA is the most popular non-parametric assumption to assessing efficiency in the banking sector. DEA methods have two models. The first method are based on Farrell’s efficiency evaluations and it is called CCR model. The second model is BCC model, introduced by Banker as an extension version of the CCR.

CHAPTER 5.

FINANCIAL PERFORMANC

5.1 Financial Reporting of Banks

According to IAS 1, the main objective and purpose financial statements is to supply wide range of users with data, which is about the financial performance, financial position, and cash flows of an organization. This information is useful because it plays guideline role for these wide range of users about making economic decisions. So, financial statements provide following information about entity for meeting that objective:

- Assets,
- Liabilities,

- Equity,
- Income,
- Expenses,
- Cash flows.

The information aforementioned, along with other data in the notes, helps users of financial statements in expressing outcome in advance the company's future cash flows and, particularly, their timing and certainty.

A whole set of financial statements involves:

-a statement about financial position of an organization at the end of the period (balance sheet);

-a statement about profit or loss (income statement) and other comprehensive income for the accounting period;

-a statement about changes in equity of an organization for the accounting period;

-a statement about cash flows of an entity for the accounting period;

-notes, explanatory notes and including a summary of accounting policies;

-comparative data prescribed by the standard.

Each of these statements provides information that is different from others, but simultaneously, they are tightly related, because each of them demonstrates different aspects of identical business changes.

5.1.2 Statement of Financial Position- Balance sheet of Banks

A statement of financial position is a financial report that demonstrates the value of an entity's assets, liabilities, and equity at a particular period of time. This period usually is considered end of an accounting period, as a year. So that, elements of balance sheet are assets, liabilities and shareholders' equity. An asset can be defined as anything company sells for getting value. Turning to liability, it is an obligation and it must eventually be paid. The last, equity in a bank is referred to as capital of bank, or equity is something that lefts when all assets have been sold out and whole quantity of liabilities have been paid. It is clear that there is connection among assets, liabilities and equity. The relationship of these elements of a bank is described by the following equation, which we know as a key accounting formula:

Bank Assets = Bank Liabilities + Bank Capital

It is so simple to explain particular formula, so, when a bank buys assets, it uses liabilities. By utilizing liabilities, such as borrowings or deposits, to finance assets, such as credits to businesses or individuals, or to purchase interest-earning securities, the shareholders of the bank can use their bank capital to gain much more.

Revenue related to assets for the bank include:

- Cash and cash equivalents
- Investment property
- Amounts due from credit institutions
- Derivative financial assets
- Investment securities
- Trading securities
- Loans to customers
- Property and equipment
- Deferred income tax assets
- Current income tax assets
- Goodwill and other intangible assets
- Other assets.

It is required that company should present classified balance sheet. Classified balance sheet means, company must separate current and non-current assets, also current and non-current liabilities. In both cases, if an assets or liability category consolidates the amounts to be received (reconciliation) of assets or liability to be received within 12 months, footnote disclosures separating long-term amounts are required from 12 months.

Current assets are:[26]

expected that the entity will be occurred principally in the normal course of trading activities expected to occur after the end of the reporting period, cash and cash equivalents (12 months).

All other assets are not current.

The current liabilities are as follows:[27]

The operator is expected to be included in the normal business cycle in order to be traded within 12 months, during which the operator has no unconditional right to reach settlement within 12 months (the exemption of equity instruments does not affect the classification system).

Other liabilities are not current.

When a debt is a non-current situation, and expected to be financed again under an actual loan facility, and the company has the caution to do so, the liability is classified as not current, otherwise, even if the obligation will be paid within 12 months. [28]

If the obligation has become borrowed on demand because an organization has imposed an undertaking under a long-term credit agreement on or prior the reporting date, the obligation is current, otherwise if the bank has agreed, afterwards the reporting date and prior the authorization of the financial statements for argument, not to request payment as an outcome of the breach. [29]

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[26] IAS 1.66
[27] IAS 1.69
[28] IAS 1.73
[29] IAS 1.74

However, if the lender accepts the reporting date to extend a period of at least 12 months after the end of the reporting period, the borrower is classified as current. [30]

Face items

Face items to be included in the statement of financial position:

(a) property, plant and equipment

(b) intangible assets

(c) investment property

(d) Excludes amounts shown in financial assets ((e), (h) and (i)).

(e) investments counted for utilising the equity method

(f) inventories

(g) biological assets

(h) cash and cash equivalents

(i) trade and other receivables

(j) commercial liabilities and other liabilities

(k) assets held for sale

(i) provisions

(m) financial liabilities (except for amounts described under (k) and (i))

(n) Current tax assets and current tax liabilities as defined in IAS 12

(o) deferred tax assets and deferred tax liabilities as defined in IAS 12

(p) debts included in disposal groups

(q) Non-controlling interests shown in owners’ equity

(r) Issued principals and reserves attributable to parents' owners.

[30] IAS 1.75

Further line items, subtotals, and titles may be required to present the business's financial condition fairly. [IAS 1.55][31]

When an organization presents sub-totals, these sub-totals will consist of line items that are accounted for and measured according to IFRS; It must be presented and labeled clearly and understandably; be consistent with the period; and will not be more prominently displayed than necessary subtotals and aggregates.

Other sub classifications of submitted line items are made in declarations or grades, for example:

kinds of PP&E, disaggregation of receivables, also disaggregation of inventories according to IAS 2

Separation of mortgages of inventories according to IAS 2, disposals of property, plant and equipment and other asset classes, equity and reserves.

Form of expression

IAS 1 does not define the format of the balance sheet. Assets can be described current then not current ones, or conversely, and equity and liabilities can be described current then not current then equity, or opposite. A net assets equitation (assets - liabilities) is allowed.

Long-term financing approach used in the UK and elsewhere - fixed assets + current assets - short-term debt = long-term debt plus equity.

Capital and reserves

The following explanations regarding the issued capital and reserves are required: [32]

amounts of shares authorized, fully paid and issued, and also issued but completely paid face value (or the shares do not have a face value) a conciliation

[31] IAS 1.55
[32] IAS 1.79

again of the amounts of shares outstanding at the inception and the final of the period characterization of preferences, rights, and limits treasury shares, containing shares kept by associates and subsidiaries shares reserved for publication under contracts and options a definition of the purpose and nature of every reserve within equity.

Additional information is required for businesses that do not have capital and that an entity has reclassified recoverable financial assets.

As we know, key service that bank offers is to supply cash depending on demand. There can be two cases; depositor can withdraw money and customer can draw credit. In addition, banks need capital funds for paying bills, and bills are predictable, however cash withdrawals by clients are not predictable as bills in both timing and amount. As we know, the important service offered by the bank is to provide cash depending on the student. There can be two situations; deposits may withdraw money and the client may withdraw the loan. In addition, banks require capital funds to pay bills and can estimate bills, but the withdrawal of customers cannot be estimated as bills in both timing and amount.

Banks must keep up a certain amount of cash compared to liabilities to keep up solvency. Banks must hold definite level of cash as reserves that is the amount of cash maintain in a bank's account at the governor (for instance Central Bank of Azerbaijan). Regulator/governor determines the minimum amount of legal reserves as cash that banks must keep up in their accounts to insure the safety of banks and by adjusting the reserve level governor can affect monetary policy. Often, banks will keep more reserves for greater safety. For most banks, loans are the major asset. They acquire more interest than banks should pay on deposits, so that, they are a major source of income for a bank. Deposits of customers and money, which banks borrow from different sources, are considered liabilities of banks. Money that the banks owe to the customers is called deposit. Banks also borrows money from other banks and financial institutions. As a final resort, banks can borrow from the Central bank, although they rarely do this. Borrowing money from Central Bank means bank is under financial stress that is the reason unable to get money for funding elsewhere. Another fund source is owners, so that, banks can get funds from their shareholders in form of extra share capital.

5.1.3 Statement of Comprehensive Income – Income statement of Banks

To understand how well a bank works, we have to look at the comprehensive income table of a bank. We can see origins of income, and expenses that could affect the profitability of the bank, in this statement. Operating income comes from ongoing operations of a bank. A large part of the operating income of a bank is the difference between the interest income on its assets, in particular the interest on debts and debts. It also includes interest-free revenues, which often do not make a difference.

Fees and commission incomes and expenses of the services provided by the bank to the customers and from other banks and the Central Bank.

Operating expenses contain the costs of conducting a banking business: rents at bank buildings, salaries for employees, marketing, IT spending, professional and legal services, and depreciation. A very important and important item in the income statement is the provision for impairment of loan losses. If a bank predicts a bad debt or a debt in the future could be a bad debt, it can write the loss as the current expense in the income table. The impairment relates directly to the credit loss on the balance sheet. Credit loss reserves increase with increasing costs because losses have not yet occurred, because earnings are allocated to deal with future losses. Provisions for credit losses have been an important factor in the fluctuation of bank profits in Azerbaijan in recent years.

5.1.4 Statement of changes in equity of Banks

Property owners have invested in their business to maximize their wealth, and they want to know how their financial position and financial performance affect their equity investment. The statement of changes in shareholders 'equity includes the statement of changes in shareholders' equity, which includes equity, in reserves that include equity. The movements that take place in the equities of the account period include the following elements:

- Net profit or loss along the accounting cycle attributable to owners;
- Changing in shares;
- Dividend fees to shareholders;
- Growth or decline in capital reserves;
- Earnings and deficits recognized precisely in equity;
- Outcome of changes in accounting codes;
- Outcome of correction of previous period mistake.

5.1.5 Statement of cash flow of Banks

The cash flow table combines the details of the statement of comprehensive income and the statement of financial position to present a summary of the cash inflows and workflow outflows. Cash flow statement includes three sections. These three parts of the cash flow statement are operating, investing and financing. Two methods can be used to prepare the cash flow declaration, direct method and indirect method. A cash flow table is a summary of transactions that affect cash or cash flow, cash equivalents at a given time. A summary of all cash payments and cash receipts for months, quarters or years business. Every section of the cash flow chart will tell you about the business activities and where the cash came from or where it went. The cash flow statement also eliminates any non-cash transactions in the income statement, such as depreciation for fixed and intangible assets. This allows us to see how the business looks at cash-generating or cash-generating areas. This information can be used to conduct operations with the company, or regulations for investment or financing activities.

5.1.6 Financial Reporting of PASHA Bank

PASHA Bank is a leading corporate bank in Azerbaijan. Established in 2007, a number of corporate banking services - including lending, transaction banking, capital market services, and financial consulting - are available to foreign companies, both domestic customers and businesses seeking to do business in the region. The Bank offers a range of financial products backed by trade financing partnerships with international banks and financial institutions. The bank also provides insurance services to legal entities and is the first company to act as a market maker in the local securities market. Since 2011, PASHA Bank has provided private banking services to HNWIs including deposits, loans and financial planning. PASHA Bank's authorized capital amounted to 333 million AZ, the largest capital-owned private bank in Azerbaijan. PASHA Bank operates approximately 450 personnel in its head office, four branches in Baku and two regional branches in Ganja and Zakatala. In February 2013, the bank established PASHA Bank Georgia, the first bank. December 2014, Turkey gave permission to pass regulatory authorities PASHA Bank's operations in Turkey. These grades are among the highest in all private banks in Azerbaijan with 100% domestic capital. PASHA Bank is part of the PASHA Group, a large investment-holding group in Azerbaijan. The Group also includes significant assets in insurance, real estate development, construction, tourism and other businesses. Kapital Bank, one of the biggest retail banks in Azerbaijan, belongs to PASHA Group. The Bank is committed to establishing and developing long-term and supportive relationships with the growing customer base. It aims to offer banking services to the highest level of international transparency and service built on five core values: Quality, Profitability, Integrity, Cooperation and Entrepreneurship.

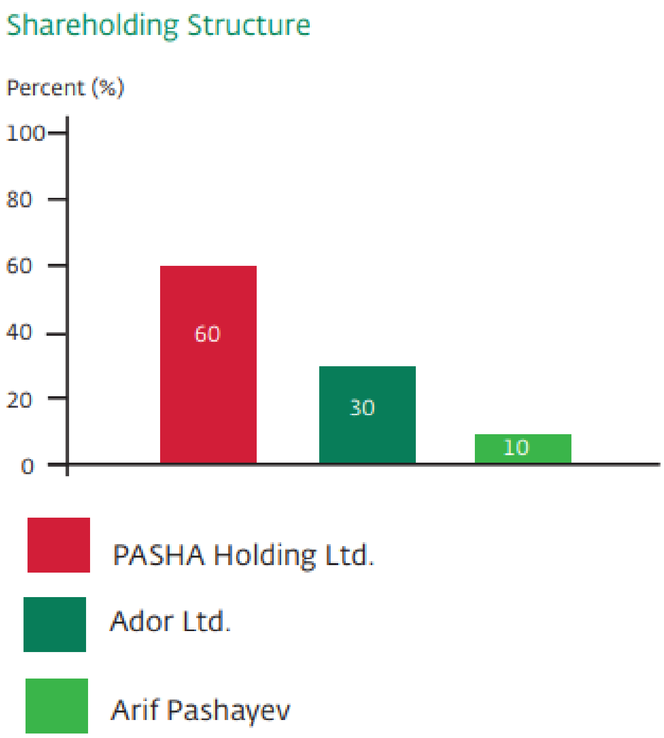


Figure 3.

TOTAL ASSETS:	*AZN 4 billion*
TOTAL EQUITY:	*AZN 800 million*
EMPLOYEES:	*2500+*

In 2016, net profit of the Bank boosted about fourfold to 69.3 million AZN.[33]

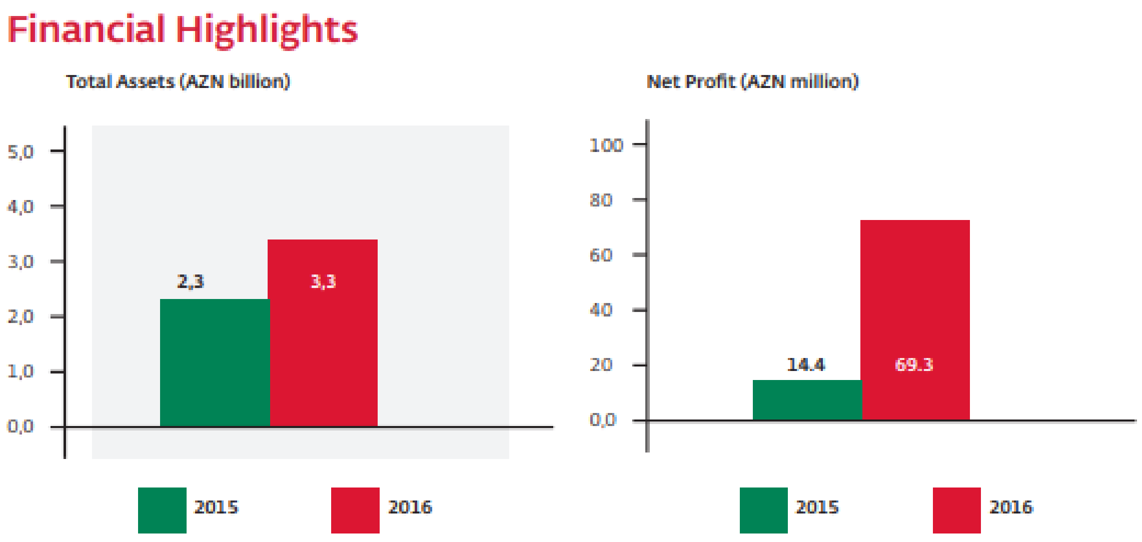
[33] Annual report of PASHA Bank, 2016

Key Financial Highlights (AZN million)

	2014	2015	2016
Total Assets	1,273.3	2,292.7	3,289.8
Loans (net)	538.9	902.2	1,107.3
Deposits	703.1	1,374.1	2,350,7
Customer Time Deposits	144.8	472.9	1,352.3
Customer Current Accounts	558.2	901.2	998.9
Shareholders' Equity	323.7	432.4	487.3
Interest Income	64.3	100.3	157.5
Fee & Commission Income	7.4	12.7	20.7
Operating Profit	60.2	116.3	186.5
Total Operating Expenses	29.3	47.4	80.6
Net Profit	-2.8	14.4	69.3

Key Financial Ratios (%)

	2014	2015	2016
Loans/Total Assets	42.3	39.4	33.7
Loans/Deposits	76.6	65.7	47.1
NPL Ratio*	10.76	3.82	8.25
Demand Deposits/ Total Deposits	79.4	65.6	42.5
Shareholders' Equity/ Total Liabilities	34.1	23.2	17.3
Capital Adequacy Ratio	33	17	20



PASHA Bank is enthusiastically committed to providing corporate, commercial and investment banking services with transparent business practices and an ethical approach, at the forefront of rising trade and investment flows in the region.

PASHA Bank Georgia

PASHA Bank opened its first branch in February 2013 in Tbilisi, Georgia. The Bank has chosen Georgia to be the first country in the world to expand for many reasons, including increased trade volume between the two countries and the joint participation of Georgia and Azerbaijan in the implementation of strategic regional projects. At present, many Azeri companies, including PASHA Bank customers, are in operation in Georgia. The bank's subsidiary makes it easier to serve better existing customers and grow their customer base. Another important objective of this initiative is to contribute to the development of both the Georgia and Azerbaijani economies. By the end of 2016, PASHA Bank Georgia had total assets above the 282 million GEL.

PASHA Bank Georgia benefits from its experience in a variety of markets to offer customers exclusive products and services with the best practices around the world as a regional bank. PASHA Bank Georgia is the foundation of its corporate strategy, which aims to reach the "New Summit Together Together" by contributing the interests of its partners to sustainable development. PASHA Bank Georgia has expanded open competitive advantages in definite product areas such as debt capital market transactions, benefiting from PASHA Bank's significant experience in the capital market environment of Azerbaijan for many years.

PASHA Bank Georgia attaches special importance to the development of trade financing business. PASHA Bank's presence in the three major economies in the region makes the Bank a strong position to offer a unique value proposition for the customer base.

Financial highlights (GEL thousand)	
Net Profit	4,881
Gross Loans	97,210
Total Assets	282,485
Key ratios	
Cost to Income	64%
ROAE*	5%
NPL to Gross Loans	0%

PASHA Bank Turkey

One of Turkey's 20 largest economies after carefully evaluating all options market entry in Turkey, the Bank's Board of Directors has decided to establish a partnership with TAIB Bank in the acquisition and Aksoy Holding a majority stake. This transaction was a natural extension of this partnership, as PASHA Bank was a long-term, trust-based work relationship with Aksoy Holding. PASHA Bank and Aksoy Holding saw a one-off opportunity to benefit from their reliable partners and build on existing market knowledge and capital.

December 2014 PASHA Bank, Turkey's Banking Regulation and Supervision Agency (BRSA) by the Turkish market, Aksoy Holding from TAIB Bank was entitled to enter by taking a majority stake. With this purchase, the Bank plans to target corporate customers resident in Turkey.

Turkey market also Azerbaijan, Georgia, and small and medium enterprises seeking investment opportunities in other countries in the region has a great potential for businesses. In addition, the Bank seeks to bring the Azerbaijani investments in Turkey to better understand the huge potential offered by the local projects. PASHA Bank thinks that alluring new foreign direct investment from Azerbaijan to the Turkish economy will benefit both economies. It will also create an excellent opportunity for existing customers and potential customers to grow and expand. PASHA Bank Turkey, which exports the first debt of 37.5 million TL has successfully completed the sale of bank bonds to qualified investors, in 2016. PASHA Bank Turkey's bonds began to be traded on Istanbul Stock Exchange in the relevant market. Following the bond issue in October, Fitch Ratings PASHA Bank Turkey's long-term credit rating of AA (tur) has confirmed. PASHA Bank Corporate Governance Rating of Turkey in the year, PASHA Bank's corporate governance principles and by proving to the importance given to the commitment to sustained success has been upgraded to the 92.64 level.

Key financial highlights and ratios	(TL million)
Total Assets	510
Shareholders' Equity	245
Total Loans	404
Net Profit	14
Paid-in Capital	255
ROE	5.9%
CAR (unconsolidated)	53.85%

Review of Financial Statements

PASHA Bank is determined to grow even further in the financial sector of Azerbaijan. The bank aims to be one of the leading financial service providers in the corporate and private banking segments by adopting transparent business practices and increasing the transparency of the banking sector.

Keeping high characteristic assets is one of the Bank's core objectives during the current strategic plan period from 2015-2017. The bank has differentiated its assets among high liquid and semi-liquid assets and created a balance between profitability and risk.

The Bank has secured the position of the largest commercial bank with total equity of 487 thousand 266 thousand AZN (2015: AZN 432.489 thousand AZN). As of the end of 2016, PASHA Bank recorded total assets (2015: AZ 2,292,739 thousand) with an increase of 43% compared to the previous year, amounting to 3,289,845 thousand. Assets of the Bank is as following, 31 December 2016:

- Other non-current and current assets – 2%
- Securities portfolio – 8%
- Due from credit institutions – 22%
- Loans to customers – 34%,
- Cash and cash equivalents – 34%

PASHA Bank increased its gross credit portfolio by 23% to 2014 (2015: AZN 949.848 thousand) by creating strong credit growth in 2016. The effective provision ratio in the portfolio is 5.3% (2015: 5,0%). In 2016, the proportion of loans that were found to be impaired in the gross portfolio rose to 8.25% (2015: 3.82%). When the market is soft, the customers benefit consistently from the relationships they have developed over the last few years, continuing to serve. As a result, PASHA Bank has established a customer deposit base amounting to 2,350,687 thousand (2015: AZN 1.374.113 thousand) in 2016 with an increase of 71% compared to the same period of previous year. Customer deposits were predominantly 42% and 58% in demand and concentration (2015: 66% and 34% respectively). The Bank disclosured net profit of 69,288 thousand AZN for accounting year 2016. Total operating income was AZN 186,499 thousand for period, a growth of 60% year-on-year. While the Bank's interest incomes totaled 157,122 thousand, primary income was AZN 82,003 thousand. As a result, the ratio of non-interest income to total operating income was 44%. Through extensive discussions with international financial institutions, PASHA Bank has been able to offer more commercial financing to corporate clients by accessing a broader range of financial instruments. The Bank also obtained better conditions for financing of consumers after receiving a debt ranking from two global rating firms. At an institutional position, the Bank has organized several seminars and workshops to strengthen the capacity of its clients to deliver professional services on time. In 2016, documentary operations costs (including post financing) amount to AZ 303.727 thousand (2015: AZN 347,134 thousand).

Consolidated Balance sheet of PASHA Bank at 31 31 December 2016

(Figures are in thousands of AZN)

	Notes	2016	2015
Assets			
Cash and cash equivalents	6	1,105,769	1,021,306
Trading securities	7	22,669	46,238
Amounts due from credit institutions	8	728,121	137,895
Investment securities			
- available-for-sale	9	173,329	5,696
- loans and receivables	9	61,220	87,903
Derivative financial assets	19	984	324
Loans to customers	10	1,107,274	902,150
Investment property	11	1,654	1,668
Property and equipment	12	12,809	15,851
Goodwill and other intangible assets	13	55,067	56,730
Current income tax assets		–	287
Deferred income tax assets	20	1,647	1,555
Other assets	14	19,302	15,136
Total assets		3,289,845	2,292,739
Liabilities			
Amounts due to banks and government funds	15	330,294	369,693
Amounts due to customers	16	2,350,687	1,374,113
Other borrowed funds	17	51,473	93,814
Debt securities issued	18	18,705	–
Derivative financial liabilities	19	2,468	991
Current income tax liabilities		12,436	–
Deferred income tax liabilities	20	8,446	9,688
Provision for guarantees and letters of credit	23	6,959	379
Other liabilities	14	21,111	11,572
Total liabilities		2,802,579	1,860,250

	Notes	2016	2015
Equity			
Share capital	21	333,000	333,000
Retained earnings		83,152	19,283
Net unrealised loss on investment securities available-for-sale		(1)	(100)
Foreign currency translation reserve		71,046	80,244
Total equity attributable to shareholders of the Bank		487,197	432,427
Non-controlling interests		69	62
Total equity		487,266	432,489
Total liabilities and equity		3,289,845	2,292,739

Signed and authorised for release on behalf of the Executive Board of the Bank:

Taleh Kazimov — Chairman of the Executive Board

Hayala Nagiyeva — Chief Financial Officer

17 March 2017

Consolidated income statement for 31 December 2016

(Figures are in thousands of AZN)

	Notes	2016	2015
Interest income			
Loans to customers		105,063	78,032
Amounts due from credit institutions		35,647	6,799
Investment securities available-for-sale		9,755	6,846
Cash and cash equivalents		2,122	3,382
Securities purchased under agreements to resell		–	61
		152,587	95,120
Trading securities		4,915	5,160
		4,915	5,160
Interest expense			
Amounts due to customers		(40,530)	(16,700)
Amounts due to banks and government funds		(10,185)	(5,401)
Other borrowed funds		(1,757)	(2,174)
Debt securities issued		(396)	–
Other		(138)	(60)
		(53,006)	(24,335)
Net interest income		104,496	75,945
Provision for impairment of interest earning assets	23	(11,447)	(52,171)
Net interest income after provision for impairment of interest bearing assets		93,049	23,774
Net fee and commission income	24	12,564	7,686
Net gains/(losses) from trading securities		109	(3,678)
Net gains/(losses) from investment securities available-for-sale		84	(145)
Net gains from foreign currencies:			
-dealing		57,810	17,635
-translation differences		8,699	12,992
- operations with foreign currency derivatives		2,304	5,467
Other income		433	351
Non-interest income		82,003	40,308

	Notes	2016	2015
Personnel expenses	25	(35,358)	(21,835)
General and administrative expenses	25	(33,449)	(21,265)
Depreciation and amortisation	12, 13	(6,678)	(4,342)
Goodwill impairment	13	(3,642)	–
Loss on initial recognition of financial assets at fair value		(1,474)	–
(Provision)/reversal of provision for guarantees and letters of credit	23	(6,580)	2,304
Non-interest expenses		(87,181)	(45,138)
Profit before income tax expense		87,871	18,944
Income tax expense	20	(18,583)	(4,561)
Net profit for the year		69,288	14,383
Attributable to:			
- shareholders of the Bank		69,281	14,380
- non-controlling interests		7	3
		69,288	14,383

Consolidated Comprehensive Income Statement for 31 December 2016

(Figures are in thousands of AZN)

	Notes	2016	2015
Net profit for the year		69,288	14,383
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods:			
Gross unrealised gains/(losses) on investment securities available-for-sale		208	(393)
Realised gains/(losses) on investment securities available-for-sale reclassified to the consolidated statement of profit or loss		(84)	145
Net unrealised gains/(losses) on investment securities availablefor-sale	21	124	(248)
Tax effect of net gains/(losses) on investment securities available-for-sale	20	(25)	50
Foreign currency translation differences	21	(9,198)	83,707
Net other comprehensive (loss)/income to be reclassified to profit or loss in subsequent periods		(9,099)	83,509
Total comprehensive income for the year		60,189	97,892
Attributable to:			
- shareholders of the Bank		60,182	97,889
- non-controlling interests		7	3
		60,189	97,892

Consolidated statement of change in shareholders' equity for 31 December 2016

(Figures are in thousands of AZN)

	Attributable to shareholders of the Bank						
	Share capital	Retained earnings (accu-mulated deficit)	Net unrealised gain/(losses) on investment securities avai-lable-for-sale	Foreign currency translation difference	Total	Non-controlling interests	Total equity
As at 31 December 2014	333,000	(5,929)	98	(3,463)	323,706	–	323,706
Net profit for the year	–	14,380	–	–	14,380	3	14,383
Other comprehensive income for the year	–	–	(198)	83,707	83,509	–	83,509
Total comprehensive income for the year	–	14,380	(198)	83,707	97,889	3	97,892
Cancellation of dividends declared in 2014 (Note 21)	–	10,832	–	–	10,832	–	10,832
Acquisition of subsidiary (Note 5)	–	–	–	–	–	97	97
Decrease in non-controlling interest	–	–	–	–	–	(38)	(38)
As at 31 December 2015	333,000	19,283	(100)	80,244	432,427	62	432,489
Net profit for the year	–	69,281	–	–	69,281	7	69,288
Other comprehensive loss for the year	–	–	99	(9,198)	(9,099)	–	(9,099)
Total comprehensive income for the year	–	69,281	99	(9,198)	60,182	7	60,189
Dividends to shareholders of the Bank (Note 21)	–	(5,412)	–	–	(5,412)	–	(5,412)
31 December 2016	333,000	83,152	(1)	71,046	487,197	69	487,266

Consolidated Cash flow statement for 31 December 2016

(Figures are in thousands of AZN)

	Notes	2016	2015
Cash flows from operating activities			
Interest received		130,157	88,989
Interest paid		(38,697)	(22,444)
Fees and commissions received		20,730	12,337
Fees and commissions paid		(8,117)	(4,926)
Net realized losses on sale of investment securities available-for-sale		84	(145)
Net realized gain from trading securities		1,017	178
Realised gains less losses from dealing in foreign currencies and operations with foreign currency derivatives		60,747	23,641
Personnel expenses paid		(26,041)	(18,430)
General and administrative expenses paid		(32,262)	(18,790)
Other operating income received		382	334
Cash flows from operating activities before changes in operating assets and liabilities		108,000	60,744
Net (increase)/decrease in operating assets			
Trading securities		22,274	(28,098)
Amounts due from credit institutions		(583,565)	63,618
Loans to customers		(179,617)	(202,467)
Other assets		(1,095)	(597)
Net increase/(decrease) in operating liabilities			
Amounts due to banks and government funds		(72,062)	19,990
Amounts due to customers		874,709	342,791
Other borrowed funds		(48,120)	(6,976)
Derivative financial liabilities		1,110	–
Other liabilities		(1,497)	1,022
Net cash flows from operating activities before income tax		120,137	250,027
Income tax paid		(6,252)	(970)
Net cash from operating activities		113,885	249,057

Cash flows from investing activities			
Acquisition of a subsidiary, net of cash acquired (Note 5)		–	371
Purchase of investment securities available-for-sale		(231,358)	(539,479)
Proceeds from sale and redemption of investment securities available-for-sale		78,569	690,411

	Notes	2016	2015
Purchase of investment securities – loans and receivables		(27,105)	–
Proceeds from sale and redemption of investment securities – loans and receivables		50,627	–
Purchase and prepayments for property and equipment		(2,356)	(3,999)
Acquisition of intangible assets		(4,526)	(4,406)
Proceeds from sale of property and equipment		34	1,410
Net cash (used in)/from investing activities		(136,115)	144,308
Cash flows from financing activities			
Proceeds from debt securities issued	18	19,258	–
Dividends paid	21	(5,412)	–
Net cash from financing activities		13,846	–
Effect of exchange rates changes on cash and cash equivalents		92,847	279,961
Net increase in cash and cash equivalents		84,463	673,326
Cash and cash equivalents, beginning	6	1,021,306	347,980
Cash and cash equivalents, ending	6	1,105,769	1,021,306

5.2 Financial Analysis

Financial analysis is formed of techniques and tools applied experimentally to generally used FSs such as statement of financial position, statement of profit or loss, etc. and various connected information to identify useful data in making decisions. For investment objectives, it is utilized as a screening tool to identify which firms are worth for investing and as a predicting tool to guess how well a company will behave in the future. Financial analysis also has an identification function and it is look at financing, operating, investing activities and their effectiveness, as well as, measuring the effect of business and managerial decisions. A broad analysis of a company's FSs, first, demonstrates its strengths and weaknesses. From evaluating prior and current FSs, analysts can collect the company's actual financial structure and condition. This contains how company finances its business, whether it has sufficient liquid assets to fulfill its short-term duties, if it has an effective and efficient asset control policy, its competitiveness in particular sphere while staying profitable and its long-dated debt financing. All of mentioned activities helps to identify the company's long-term viability. Researchers of FSs may also discover pertinent information for managers of a company concerning recent trends and occurrences that can influence further implementation or planning of management policy. Such data may revise the decisions already made to ensure that the shareholder wealth is maximized responsibly. A summary of the main causes of financial analysis is as follows:

a. For creditors:

- To discover reasons for an organization's need of extra financing;
- To discover how a debtor arranges to pay back interest and principal;
- To evaluate how prior debts were handled;
- To be aware of whether there would be extra requests for forthcoming financing.

b. For present and potential shareholders:

- To view the firm’s current and long-term operations;
- To assess forthcoming revenue potential;
- To discover the present financial condition of the firm and the factors related to this;
- To identify the company’s capital structure and also identify that if this capital benefits the company;
- Position of company with regards to competitors.
- The exposure of its income to significant variability;

5.2.1 Users of Financial Analysis

Beneficiaries of financial analysis results are not limited to these. company but also in other business matters. These include not only direct but also interests but indirectly. They are usually classified in two groups.

- External users: those who are indirectly involved in the company and who have knowledge only given by management.
- Internal users: direct participants to the company, such as managers and other. In general employees who have access to all information about the company.

<u>External Users</u>

- Acquisition and merger analysts – they use FA to compare relevance of potential merger candidates concerning their finances and operations.
- Partners (including suppliers and customers) – they are interested in if a long-term relation can be sustained between the firm and them, outcomes of FA can supply an comprehension into the stability of the company.
- Equity investors – they contain present and potential shareholders, present ones need it to make a determination if to maintain stock or sell the stock. Potential ones use the data to assist in choosing among challenging

alternative investments. Potential shareholders are commonly interested in the forthcoming profitability and riskiness of the firm.

- Auditors – they find out areas where the firm is falling short or improving in its financial management.
- Creditors – these include bondholders, banks, etc. who lend cash or cash equivalents to firms both on short or long-term basis, their key interest is in analyzing FSs to discover if firms have the capability to pay back money with interest in a certain time period.
- Regulatory agencies (and government) – they use FA to correctly supervise the actions and operations of firms.
- Brokers and intermediaries – they require the information collected to advise clients and the firms about investment chances, announcing of yearly reports and other FSs tend to influence trading of listed firms' stocks.
- General public – undergraduates may find useful data from FS for research, other individuals use the data as criteria for choosing potential employers.

<u>Internal Users</u>

- Managers –are an essential part of an organization and use outcomes of FA to make decisions, which positively affect the firm. They need to identify how past decisions have influenced company performance and if to go on with the practices which influenced the company.
- Shareholders/owners – they use FA to evaluate if resources are being used effectively by management also enough returns on investment.
- Internal auditors – they use FA to discover whether the company is using resources of firm for what management has plan to do
- Employees – they are interested in the FA of the company and how current condition may influence the ongoing employment, pensions, wages, and benefits.

5.3 Profitability ratios

Profitability ratios indicate a company's whole performance and efficiency. They measure the organization how to utilize of its assets and manage of its expenses to set up an adequate rate of return. In addition, profitability ratios are used to analyze how well the firm is acting or how well ongoing performance compares to previous records of company. Ratios of profitability are utilized to identify the effectiveness of a company’s employment of equity or assets to generate profit. As we know, maximizing profit is the key objective of any company, poor outcomes here would display a weakness that if not corrected.

There are five key profitability ratios:

- Net Profit Margin
- Return on Asset.
- Return on Equity
- Gross Profit Margin
- Operating profit margin

Net Profit Margin

Net profit margin consists of post-tax net profit from net sales. It tells you how much sales have changed since sales. Higher net profit margins are better for any bank.

Net Profit margin = $\frac{Net\ profit\ after\ tax}{Sales}$x100

For PASHA Bank NPM=$\frac{69,288}{186,500}$x100=37.15%

Analysis: In this analysis, we can see that the net profit margin has improved in 2016 compare than last year in PASHA Bank because sales and net profit are improved from the last year. As a result, this bank is standard position.

Return on asset ratio

The ROA rate can be calculated directly by dividing net income by the average total assets. It measures the company's ability to use its assets, as well as the efficiency of the company without profit.

ROA= $\frac{Net\ profit\ after\ taxes}{Total\ assets}$x100

ROA for PASHA Bank=$\frac{69,288}{3,289,800,000}$x100=2.1%

Analysis: From data, we can see that total asset and net income has continuously increased. That is the reason; return on total asset has increased in little bite.

Return on Equity

ROE is measured by dividing net profit minus preferred dividend by average entity stockholder equity. It shows how a company generates an increase in earnings to use an investment fund. It has an alternative name such as average common stock return, net value return, and return to ordinary shareholders' funds.

ROE= $\frac{Net\ income}{Total\ Equity}$x100

ROE for PASHA Bank=$\frac{69,288}{487,266}$x100=14.2%

Gross Profit Margin ratio

Gross profit expresses the company's efficiency in the production of raw materials and labor during the working process. If any company has a higher gross profit mark, the company more effectively controls its raw materials and work. Therefore, it is important to evaluate the effectiveness of the bank. It can be attributed to individual products or the whole company. It determines the gross profit for dividing by net sales. The formula of gross profit margin ratio;

Gross profit margin ratio= $\frac{Gross\ profit}{Sales}$x100

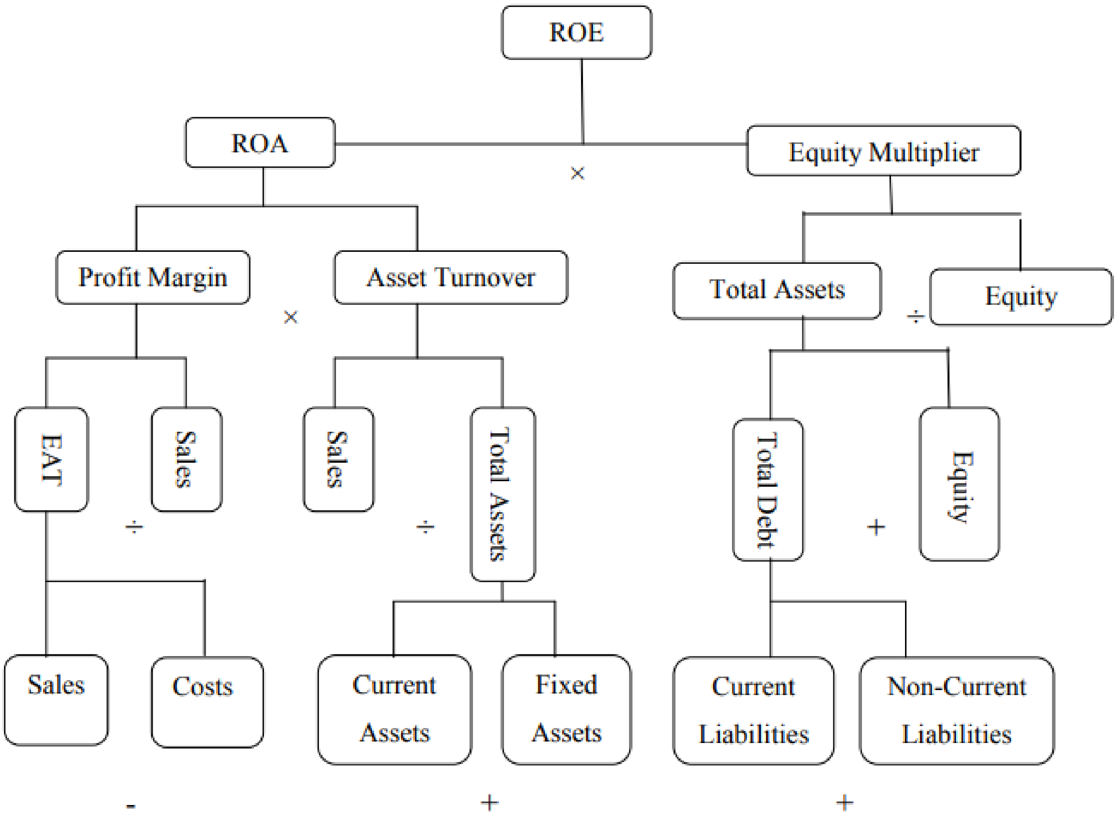
Operating profit margin ratio

The profitability ratio of operating profit reflects the percentage of sales for exchange at all costs and expenses after the remaining sales. High operating profit is preferred. OPM is calculated as:

$$\text{Operating Profit Margin} = \frac{Operating\ profit}{Sales}$$

5.3.1 Du Pont

The Du Pont evaluating method of the financial condition of a company is a method planned to help the researchers identify the drivers of a company's profitability. Du Pont destroys already stated ratios. It based on their simple components by basic mathematical methods to further assess a firm's efficiency of its operation and the financial health. The figure below demonstrates this:



The diagram that is shown above, demonstrates how ROE can be measured by finding outcomes of other ratios or amounts and combining them with analytical operations. It is to see from diagram:

$$ROE = ROA \times Equity\ Multiplier.$$

To find out the reason of the firm's success or deficiency, an observation has to be made as to which circumstance is most responsible for the outcome of ROA/ROE. Total Asset Turnover is more crucial element in the equation for ROA. This shows that despite the stability of the assets of the assets, low profit margins prevent the company's progress from turning its assets into higher returns. This shows evidence of the company's income. They are very low compared to the related costs. Turning to, ROE is considered, it is recognized that it is the driving force behind the capital multiplier. ROE is low even when the equity multiplier is relatively high. This shows that the firm has a higher financial risk because it is financed by higher debt and lower return potential, which means lower debt incomes (post-tax gains) due to lower profit margins.

5.3.2 Profitability in PASHA Bank

The purpose of any bank is to generate enough income to cover its expenses. Moreover, banks aims to be profitable as any business. The main origin of income is the interest payments from the loans. Profitability is the key goal of all business initiatives that are important for long-term viability. In this context, it is extremely crucial to assess past, present and future profitability to anticipate and prevent adverse outcomes. Factors determining profitability are income and expenses that are significant in the financial statements in the annual period.

PASHA Bank is determined to grow even further in the financial sector of Azerbaijan. The bank aims to be one of the leading financial service providers in the corporate and private banking segments by adopting transparent business practices and increasing the transparency of the banking sector. The bank has diversified its assets among high liquid and semi-liquid assets and created a balance between profitability and risk.

Key Financial Highlights (AZN million)

	2014	2015	2016
Total Assets	1,273.3	2,292.7	3,289.8
Loans (net)	538.9	902.2	1,107.3
Deposits	703.1	1,374.1	2,350,7
Customer Time Deposits	144.8	472.9	1,352.3
Customer Current Accounts	558.2	901.2	998.9
Shareholders' Equity	323.7	432.4	487.3
Interest Income	64.3	100.3	157.5
Fee & Commission Income	7.4	12.7	20.7
Operating Profit	60.2	116.3	186.5
Total Operating Expenses	29.3	47.4	80.6
Net Profit	-2.8	14.4	69.3

CHAPTER 6.

CONCLUSION

Low ROE will force owners to make significant changes in the allocation of short-term capital. However, in some countries the decision to allocate the capital to the bank will depend on the expected ROE. In the international environment, the capital will receive no interest in entering or engaging in Azerbaijan if it will be less harmful than other countries with comparable levels of investment risk, or will provide significantly lower returns to its owners. In fact, the Azerbaijani banks, which are limited in the possible increase in the quality loan portfolio, which is the main source of the profitability of the banks, still have enough space to decrease the interest rate on the loans and thus increase the demand and quality loan portfolio. Banks should also increase their cost efficiency. This chapter is directly related to the purpose. Analyzes will be summarized to answer research questions and achieve the thesis objective. First, we analyzed literatures about PMSs, and then we investigated performance measurement system of companies. Next, in Chapter 5 we discussed financial performance of an organization. We looked to financial reporting of PASHA Bank in detailed and calculated profitability ratios of particular bank. This thesis was directed to assess efficiency and profitability of PASHA Bank. The result of the thesis revealed that the profitability is an essential and traditional tool of performance appraisal. The profitability ratios of the bank performance using ROA revealed that it is the best tool for measuring financial performance.

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