OJSC PASHA Bank
Consolidated financial statements

Year ended 31 December 2012
Together with Independent auditors' report

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Independent auditors' report

To the Shareholders and Board of Directors of OJSC PASHA Bank

We have audited the accompanying consolidated financial statements of OJSC PASHA Bank and its subsidiary, which comprise the consolidated statement of financial position as at 31 December 2012, and the consolidated income statement, consolidated statements of comprehensive income, of changes in equity and of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, 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.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of OJSC PASHA Bank and its subsidiary as at 31 December 2012, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young Holdings (CIS) B.V.

11 March 2013

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2012

(Figures in Tables are in thousands of Azerbaijani Manats)

	Notes	*31 December 2012*	*31 December 2011*
Assets			
Cash and cash equivalents	5	68,526	35,105
Trading securities	6	14,180	24,736
Securities purchased under agreements to resell	7	–	26,932
Amounts due from credit institutions	8	14,960	24,684
Investment securities available-for-sale	9	323,699	209,307
Loans to banks	10	1,000	1,500
Loans to customers	11	274,141	234,004
Investment property	12	2,000	2,000
Property and equipment	13	8,900	4,216
Intangible assets	14	2,278	1,842
Current income tax assets	20	–	112
Other assets	15	11,391	9,442
Total assets		**721,075**	**573,880**
Liabilities			
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	16	35,045	30,896
Amounts due to customers	17	457,067	371,499
Amounts due to credit institutions	18	30,935	14,107
Current income tax liabilities		484	–
Deferred income tax liabilities	20	2,327	758
Provision for guarantees and letters of credit	23	967	1,404
Other liabilities	15	5,902	3,388
Amount reserved for increase in share capital	19	–	2,645
Total liabilities		**532,727**	**424,697**
Equity			
Share capital	21	157,000	123,475
Retained earnings		31,178	25,717
Net unrealised gains/(losses) on investment securities available-for-sale		181	(9)
Foreign currency translation reserve		(11)	–
Total equity		**188,348**	**149,183**
Total liabilities and equity		**721,075**	**573,880**

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

Farid Akhundov — Chairman of the Executive Board

Shahin Mammadov — Chief Financial Officer, Member of the Executive Board

11 March 2013

Azərbaycan Respublikası Açıq Səhmdar Cəmiyyəti PAŞA Bank Open Joint Stock Company Azerbaijan Republic

The accompanying notes on pages 6 to 43 are an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2012

(Figures in Tables are in thousands of Azerbaijani Manats)

	Notes	Year ended 31 December 2012	Year ended 31 December 2011
Interest income			
Loans to customers		34,503	26,817
Investment securities available-for-sale		9,626	5,966
Amounts due from credit institutions		2,100	2,278
Trading securities		1,428	395
Loans to banks		352	628
Securities purchased under agreements to resell		132	117
		48,141	**36,201**
Interest expense			
Amounts due to customers		(11,416)	(11,059)
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds		(1,653)	(459)
Amounts due to credit institutions		(1,213)	(801)
		(14,282)	**(12,319)**
Net interest income		**33,859**	**23,882**
Provision for impairment of interest bearing assets	23	(7,338)	(4,542)
Net interest income after provision for impairment of interest bearing assets		**26,521**	**19,340**
Net fee and commission income	24	3,543	2,446
Net gains from trading securities		720	278
Net losses from investment securities available-for-sale		(63)	–
Net gains from foreign currencies:			
- dealing		4,485	4,281
- translation differences		563	112
Other income		35	38
Non-interest income		**9,283**	**7,155**
Personnel expenses	25	(7,438)	(6,110)
General and administrative expenses	25	(6,731)	(4,512)
Depreciation and amortisation	13,14	(1,310)	(901)
Reversal of provision for guarantees and letters of credit	23	437	178
Non-interest expenses		**(15,042)**	**(11,345)**
Profit before income tax expense		**20,762**	**15,150**
Income tax expense	20	(4,551)	(1,791)
Net profit for the year		**16,211**	**13,359**

The accompanying notes on pages 6 to 43 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2012

(Figures in Tables are in thousands of Azerbaijani Manats)

	Notes	*Year ended 31 December 2012*	*Year ended 31 December 2011*
Net profit for the year		**16,211**	**13,359**
Other comprehensive income			
Net unrealised gains/(losses) on investment securities available-for-sale		237	(11)
Tax effect of net gains on investment securities available-for-sale	20	(47)	2
Loss on translation difference		(11)	–
Other comprehensive income for the year, net of tax		**179**	**(9)**
Total comprehensive income for the year		**16,390**	**13,350**

The accompanying notes on pages 6 to 43 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2012

(Figures in Tables are in thousands of Azerbaijani Manats)

	Share capital	*Retained earnings*	*Net unrealized gains/(losses) on investment securities available-for-sale*	*Foreign currency translation reserve*	*Total equity*
31 December 2010	**115,407**	**21,408**	**–**	**–**	**136,815**
Capitalization of net profit for the year 2010 to share capital (Note 21)	8,068	(8,068)	–	–	–
Dividends declared (Note 21)	–	(982)	–	–	(982)
Total comprehensive income for the year	–	13,359	(9)	–	13,350
31 December 2011	**123,475**	**25,717**	**(9)**	**–**	**149,183**
Capitalization of net profit for the year 2011 to share capital (Note 21)	10,750	(10,750)	–	–	–
Capitalization of amount reserved for increase in share capital (Notes 19 and 21)	2,645	–	–	–	2,645
Cash contribution for share capital increase (Note 21)	20,130	–	–	–	20,130
Total comprehensive income for the year	–	16,211	190	(11)	16,390
31 December 2012	**157,000**	**31,178**	**181**	**(11)**	**188,348**

The accompanying notes on pages 6 to 43 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2012

(Figures in Tables are in thousands of Azerbaijani Manats)

	Notes	Year ended 31 December 2012	Year ended 31 December 2011
Cash flows from operating activities			
Interest received		45,257	36,090
Interest paid		(13,786)	(12,166)
Fees and commissions received		4,991	3,794
Fees and commissions paid		(1,846)	(1,376)
Net realized gains from trading securities		540	658
Realised gains less losses from dealing in foreign currencies		4,485	4,281
Personnel expenses paid		(6,973)	(5,985)
General and administrative expenses paid		(6,373)	(4,437)
Other operating income received		26	8
Cash flows from operating activities before changes in operating assets and liabilities		**26,321**	**20,867**
Net (increase)/decrease in operating assets			
Trading securities		10,822	(24,082)
Amounts due from credit institutions		9,801	(2,039)
Loans to banks		500	2,993
Loans to customers		(46,182)	(52,253)
Other assets		(2,469)	(104)
Net increase/(decrease) in operating liabilities			
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds		3,923	6,886
Amounts due to customers		86,055	34,323
Amounts due to credit institutions		16,466	7,828
Other liabilities		1,713	(735)
Net cash from / (used in)operating activities before income tax		**106,950**	**(6,316)**
Income tax paid		(1,374)	(1,717)
Net cash from / (used in) operating activities		**105,576**	**(8,033)**
Cash flows from investing activities			
Securities purchased under agreements to resell		26,931	(21,156)
Purchase of investment securities available-for-sale		(584,590)	(455,795)
Proceeds from sale and redemption of investment securities available-for-sale		471,741	396,718
Purchase and prepayments for property and equipment		(4,367)	(5,243)
Acquisition of intangible assets		(723)	(547)
Proceeds from sale of property and equipment		9	34
Purchase of investment property	12	–	(2,000)
Net cash used in investing activities		**(90,999)**	**(87,989)**
Cash flows from financing activities			
Cash capital contribution	21	20,130	–
Dividends paid	21	(982)	(981)
Net cash from / (used in) financing activities		**19,148**	**(981)**
Effect of exchange rates changes on cash and cash equivalents		(304)	(784)
Net increase / (decrease) in cash and cash equivalents		**33,421**	**(97,787)**
Cash and cash equivalents, beginning	5	**35,105**	**132,892**
Cash and cash equivalents, ending	5	**68,526**	**35,105**

The accompanying notes on pages 6 to 43 are an integral part of these consolidated financial statements.

(Figures in Tables are in thousands of Azerbaijani Manats)

1. Principal activities

OJSC PASHA Bank (the "Bank") was formed on 18 June 2007 as an open joint stock company under the laws of the Republic of Azerbaijan. The Bank operates under a banking licence issued by the Central Bank of the Republic of Azerbaijan ("CBAR") on 28 November 2007.

The Bank accepts deposits from the public and extends credit, transfers payments, exchanges currencies and provides other banking services to its commercial and private customers.

The Bank has three service points in Azerbaijan as of 31 December 2012 (2011: two), one representative office and one commercial bank in the Republic of Georgia.

The Bank's registered legal address is 15 Yusif Mammadaliyev Street, Baku, AZ1005, Azerbaijan.

As of 31 December 2012 and 2011 the following shareholders owned the outstanding shares of the Bank:

Shareholders	*31 December 2012 (%)*	*31 December 2011 (%)*
Pasha Holding Ltd.	60	60
Ador Ltd.	30	30
Mr. Arif Pashayev	10	10
Total	**100**	**100**

The Bank is ultimately controlled by Mr. Arif Pashayev.

On 17 December 2012 the Bank established PASHA Bank Georgia JSC, a wholly – owned subsidiary, which will be operating in the banking sector, with registered and paid up share capital of GEL 35,000 thousands. On 17 January 2013 PASHA Bank Georgia JSC received a license for banking activities in the Republic of Georgia. As of 31 December 2012 there was no commercial activity in the subsidiary.

Legal address of the PASHA Bank Georgia JSC is 15 Rustaveli Street, Tbilisi, GE 0108, Georgia.

The Bank and its subsidiary (collectively, the"Bank") was consolidated in these financial statements.

2. Basis of preparation

General

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

The Azerbaijani Manat is the functional and presentation currency of OJSC PASHA Bank as the majority of the transactions are denominated, measured, or funded in Azerbaijani Manat. Transactions in other currencies are treated as transactions in foreign currencies.

The Bank is required to maintain its records and prepare its consolidated financial statements in Azerbaijani Manat and in accordance with IFRS.

These consolidated financial statements are presented in thousands of Azerbaijani Manat ("AZN"), except when otherwise indicated.

The consolidated financial statements have been prepared under the historical cost convention except for trading and available for sale securities which have been measured at fair value.

(Figures in Tables are in thousands of Azerbaijani Manats)

3. Summary of significant accounting policies

Reclassification

When preparing consolidated financial statements for the year ended 31 December 2012, some items in the financial statements for the year ended 31 December 2011 were reclassified to be in conformity with the 2012 presentation. The reason for reclassifications is substance of operations reflected in the consolidated financial statements.

The following reclassifications have been made to the consolidated income statement as at 31 December 2011 to conform to 2012 presentation.

	As previously reported (2011)	*Effect of reclassification (2011)*	*As reclassified (2011)*	*Notes*
Consolidated income statement				
Interest income on guarantees and letters of credit	1,557	(1,557)	–	a)
Interest expense on guarantees and letters of credit	(478)	478	–	a)
Commission income on currency conversion operations	1,108	(1,108)	–	b)
Commission expense on currency conversion operations	(23)	23	–	b)
Net fee and commission income	2,452	(6)	2,446	a), b)
Net gains from foreign currency dealing	3,196	1,085	4,281	b)
Consolidated statement of cash flow				
Cash flows from operating activities				
Interest received	37,596	(1,506)	36,090	a)
Interest paid	(12,621)	455	(12,166)	a)
Fees and commissions received	3,397	397	3,794	a), b)
Fees and commissions paid	(945)	(431)	(1,376)	a), b)
Realised gains less losses from dealing in foreign currencies	3,196	1,085	4,281	b)

a) Interest income and expense on guarantees and letters of credit in the amount of AZN 1,557 thousands and AZN 478, respectively, has been reclassified to net fee and commission income. Accordingly, cash interest received and cash interest paid in consolidated statement of cash flows in the amount of AZN 1,506 thousands and AZN 455 thousands, respectively, have been reclassified to fees and commissions received and fees and commissioin paid.

b) Commission income and expense on currency conversion operations in the amount of AZN 1,108 thousands and AZN 23 thousands, respectively, has been reclasified to net gains from currency dealing. Accordingly, fees and commissions received and fees and commissions paid in consolidated statement of cash flows in the amount of AZN 1,108 thousands and AZN 23 thousands, respectively, have been reclassified to realised gains less losses from dealing in foreign currencies.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiary for the year ended 31 December 2012. The financial statements of Pasha Bank's subsidiary are prepared for the same reporting year as Pasha Bank, using consistent accounting policies.

All intra–group balances, transactions, income and expenses are eliminated in full. Subsidiary is fully consolidated from the date on which control is transferred to the Bank. Control is achieved where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The Bank has a control over its subsidiary.

(Figures in Tables are in thousands of Azerbaijani Manats)

3. Summary of significant accounting policies (continued)

Changes in accounting policies

The Bank has adopted the following amended IFRS and new IFRIC Interpretations during the year. The principal effects of these changes are as follows:

Amendments to IFRS 7 Financial Instruments: Disclosures
The Amendments were issued in October 2010 and are effective for annual periods beginning on or after 1 July 2011. The amendment requires additional disclosure about financial assets that have been transferred to enable the users of the Bank's consolidated financial statements to evaluate the risk exposures relating to those assets. The amendment affects disclosure only and has no impact on the Bank's consolidated financial position or performance.

Other amendments resulting from Improvements to the following standards did not have any impact on the accounting policies, consolidated financial position or performance of the Bank:

- *IAS 12 Income Taxes (Amendment) – Deferred Taxes: Recovery of Underlying Assets*
- *IFRS 1 First-Time Adoption of International Financial Reporting Standards (Amendment) – Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopter*

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held to maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognized initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Bank determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

All regular way purchases and sales of financial assets are recognized on the trade date i.e. the date that the Bank commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category "financial assets at fair value through profit or loss". Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are included in Net trading income. In a currency swap, the Bank pays a specified amount in one currency and receives a specified amount in another currency. Currency swaps are mostly gross–settled.

Held to maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held to maturity when the Bank has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held to maturity investments are subsequently measured at amortized cost. Gains and losses are recognized in the consolidated income statement when the investments are impaired, as well as through the amortization process.

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 are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in the consolidated income statement when the loans and receivables are derecognized or impaired, as well as through the amortization process.

3. Summary of significant accounting policies (continued)

Financial assets (continued)

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 with gains or losses being recognized in other comprehensive income until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to the consolidated income statement. However, interest calculated using the effective interest method is recognized in the consolidated income statement.

Determination of fair value

The fair value for financial instruments traded in active market at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

Offsetting

Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the consolidated statement of financial position.

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- a financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity;
- other financial assets may be reclassified to available for sale or held to maturity categories only in rare circumstances.

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category of the Bank has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the CBAR, excluding obligatory reserves, and amounts due from credit institutions with no maturity and less than 90 days of the date of origination and that are free from contractual encumbrances.

Repurchase and reverse repurchase agreements

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the consolidated statement of financial position and, in case the transferee has the right by contract or custom to sell or re-pledge them, reclassified as securities pledged under sale and repurchase agreements.

3. Summary of significant accounting policies (continued)

Repurchase and reverse repurchase agreements (continued)

The corresponding liability is presented within amounts due to credit institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as separate account on the consolidated statement of financial position if material or as cash and cash equivalents or loans to customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds, amounts due to credit institutions and amounts due to customers. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the consolidated income statement when the borrowings are derecognised as well as through the amortisation process.

Impairment of financial assets

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

Amounts due from credit institutions, loans to banks and loans to customers

For amounts due from credit institutions, loans to banks and loans to customers carried at amortized cost, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant.

If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them 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.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in current year profit. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the consolidated income statement.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. 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.

(Figures in Tables are in thousands of Azerbaijani Manats)

3. Summary of significant accounting policies (continued)

Impairment of financial assets (continued)

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Available-for-sale financial investments

For available-for-sale financial investments, the Bank assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognized in the other comprehensive income is reclassified from consolidated other comprehensive income to the consolidated income statement. Impairment losses on equity investments are not reversed through the consolidated income statement; increases in their fair value after impairment are recognized in consolidated other comprehensive income.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

The interest income is recognized in the consolidated income statement. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated income statement, the impairment loss is reversed through the consolidated income statement.

Held to maturity financial investments

For held to maturity investments the Bank assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognized in the consolidated income statement.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, any amounts formerly charged are credited to the consolidated statement of comprehensive income.

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

(Figures in Tables are in thousands of Azerbaijani Manats)

3. Summary of significant accounting policies (continued)

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized where:

- the rights to receive cash flows from the asset have expired;
- the Bank has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- the Bank either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank's continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities

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

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

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit and guarantees. Financial guarantees are initially recognized in the consolidated financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortized premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to current year profit. The premium received is recognized in the consolidated income statement on a straight-line basis over the life of the guarantee.

The interest rate is applied to amount of guarantees without consideration of effective interest rate method.

Taxation

The current income tax expense is calculated in accordance with the regulations of the Republic of Azerbaijan.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

3. Summary of significant accounting policies (continued)

Taxation (continued)

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting date.

Azerbaijan also has various operating taxes that are assessed on the Bank's activities. These taxes are included as a component of general and administrative expenses.

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively. Where current tax or deferred tax arises from the initial accounting for a business combination, the tax effect is included in the accounting for the business combination.

Property and equipment

Property and equipment are carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of property and equipment when that cost is incurred if the recognition criteria are met.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Depreciation of an asset, including construction in progress, begins when it is ready and available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	20
Furniture and fixtures	4
Computers and other equipment	4
Vehicles	4
Other equipment	5
Leasehold improvements	15

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

Leasehold improvements are depreciated of over the useful life of the leased assets.

Costs related to repairs and renewals are charged when incurred and included in general and administrative expenses, unless they qualify for capitalization.

Investment property

Investment properties are properties which are held either to earn rental income or for capital appreciation or for both. Such properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are stated at cost less accumulated depreciation and any accumulated impairment losses.

An investment property is derecognised upon disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from the disposal. Any gain or loss arising on derecognition of the property (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss in the period in which the property is derecognised.

(Figures in Tables are in thousands of Azerbaijani Manats)

3. Summary of significant accounting policies (continued)

Intangible assets

Intangible assets consist of licenses and computer software.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be finite. Intangible assets with finite lives are amortised over the useful economic lives of 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Intangible assets with indefinite useful lives are not amortised and assessed for impairment at least at each financial year-end whenever there is an indication that the intangible asset may be impaired.

Provisions

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

Retirement and other employee benefit obligations

The Bank does not have any pension arrangements separate from the State pension system of the Republic of Azerbaijan, which requires current contributions by the employer calculated as a percentage of current gross salary payments; such expense is charged in the period the related salaries are earned. In addition, the Bank has no post-retirement benefits.

Share capital

Share capital

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognised as additional paid-in capital.

Dividends

Dividends are recognised as a liability and deducted from equity at the reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the consolidated financial statements are authorised for issue.

Contingencies

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

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. Expenses are recognized when incurred. The following specific recognition criteria must also be met before revenue and expense is recognised.

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense. Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

(Figures in Tables are in thousands of Azerbaijani Manats)

3. Summary of significant accounting policies (continued)

Recognition of income and expenses (continued)

Fee and commission income and expense

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee and commission income includes cash collection and withdrawal fees and customer services fees, which are recognized as revenue as the services are provided. Fee and commission expense consists of documentary operations (letters of credit and guarantees), customer, brokerage, custodian and foreign currency purchase/sale fees.

Foreign currency translation

The consolidated financial statements are presented in AZN, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in current year profit as gains less losses from foreign currencies – translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the CBAR exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies.

As at the reporting date, the assets and liabilities of the Bank's subsidiary whose functional currency is different from the presentation currency of the Bank are translated into AZN at the rate of exchange ruling at the reporting date and, its statement of income is translated at the weighted average exchange rates for the year. The exchange differences arising on the translation are taken to consolidated statement of comprehensive income.

The Bank used the following official exchange rates at 31 December 2012 and 2011 in the preparation of these consolidated financial statements:

	31 December 2012	*31 December 2011*
1 US Dollar	AZN 0.7850	AZN 0.7865
1 Euro	AZN 1.0377	AZN 1.0178
1 Georgian Lari	AZN 0.4744	AZN 0.4692

Future changes in accounting policies

Standards and interpretations issued but not yet effective

IFRS 9 Financial Instruments
IFRS 9, as issued, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but *Amendments to IFRS 9 mandatory Effective Date of IFRS 9 and Transition Disclosures*, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The Bank will quantify the effect of the adoption of the first phase of IFRS 9 in conjunction with the other phases, when issued, to present a comprehensive picture.

IFRS 10 Consolidated Financial Statements
IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in IAS 27. In addition IFRS 10 introduces specific application guidance for agency relationships. IFRS 10 replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. It also includes the issues raised in SIC-12 *Consolidation – Special Purpose Entities*. It is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. Currently the Bank evaluates possible effect of the adoption of IFRS 10 on its consolidated statement of financial position and performance.

(Figures in Tables are in thousands of Azerbaijani Manats)

3. Summary of significant accounting policies (continued)

Future changes in accounting policies (continued)

IFRS 11 Joint Arrangements
IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method. IFRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities – Non-monetary Contributions by Venturers* and is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The Bank expects that adoption of IFRS 11 will have no effect on its consolidated statement of financial position and performance.

IFRS 12 Disclosure of Interests in Other Entities
IFRS 12 is effective for annual periods beginning on or after 1 January 2013. IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. In particular, the Bank will need to disclose more information about the consolidated and unconsolidated structured entities with which it is involved or which it has sponsored. However, the standard will have no impact on Bank's consolidated statement of financial position or performance.

IFRS 13 Fair Value Measurement
IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. IFRS 13 is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The adoption of the IFRS 13 may have effect on the measurement of the Bank's assets and liabilities accounted for at fair value. Currently the Bank evaluates possible effect of the adoption of IFRS 13 on its consolidated statement of financial position and performance.

IAS 27 Separate Financial Statements (as revised in 2011)
As a consequence of the new IFRS 10 and IFRS 12, what remains of IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The amendment becomes effective for annual periods beginning on or after 1 January 2013. The Bank expects that these amendments will have no impact on the Bank's consolidated statement of financial position.

IAS 28 Investments in Associates and Joint Ventures (as revised in 2011)
As a consequence of the new IFRS 11 and IFRS 12. IAS 28 has been renamed IAS 28 Investments in Associates and Joint Ventures, and describes the application of the equity method to investments in joint ventures in addition to associates. The amendment becomes effective for annual periods beginning on or after 1 January 2013. The Bank expects that these amendments will have no impact on the Bank's consolidated statement of financial position.

Amendments to IAS 19 Employee Benefits
The IASB has published amendments to IAS 19 *Employee Benefits*, effective for annual periods beginning on or after 1 January 2013, which involve major changes to the accounting for employee benefits, including the removal of the option for deferred recognition of changes in pension plan assets and liabilities (known as the "corridor approach"). In addition, these amendments will limit the changes in the net pension asset (liability) recognised in profit or loss to net interest income (expense) and service costs. The Bank expects that these amendments will have no impact on the Bank's consolidated statement of financial position.

Amendments to IAS 1 Changes to the Presentation of Other Comprehensive Income
The amendments to IAS 1 change the grouping of items presented in other comprehensive income. Items that could be reclassified (or recycled) to profit or loss at a future point in time (for example, net losses or gains on available-for-sale financial assets) would be presented separately from items that will never be reclassified (for example, revaluation of buildings). The amendment affects presentation only and has no impact on the Bank's consolidated statement of financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 July 2012.

(Figures in Tables are in thousands of Azerbaijani Manats)

3. Summary of significant accounting policies (continued)

Future changes in accounting policies (continued)

Amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities
These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognized financial instruments that are set off in accordance with *IAS 32 Financial Instruments: Presentation*. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreements, irrespective of whether they are set off in accordance with IAS 32. These amendments will not impact the Banks' consolidated statement of financial position or performance and will become effective for annual periods beginning on or after 1 January 2013.

Amendments to IAS 32 – Offsetting Financial Assets and Financial Liabilities
These amendments clarify the meaning of "currently has a legally enforceable right to set-off". It will be necessary to assess the impact to the Bank by reviewing settlement procedures and legal documentation to ensure that offsetting is still possible in cases where it has been achieved in the past. In certain cases, offsetting may no longer be achieved. In other cases, contracts may have to be renegotiated. The requirement that the right of set-off be available for all counterparties to the netting agreement may prove to be a challenge for contracts where only one party has the right to offset in the event of default.

The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. While many settlement systems are expected to meet the new criteria, some may not. As the impact of the adoption depends on the Bank's examination of the operational procedures applied by the central clearing houses and settlement systems it deals with to determine if they meet the new criteria, it is not practical to quantify the effects.

These amendments become effective for annual periods beginning on or after 1 January 2014.

Amendment to IFRS 1 – Government Loans
These amendments require first-time adopters to apply the requirements of *IAS 20 Accounting for Government Grants and Disclosure of Government Assistance*, prospectively to government loans existing at the date of transition to IFRS. The amendment will have no impact on the Bank.

Improvements to IFRS

The amendments are effective for annual periods beginning on or after 1 January 2013. They will not have an impact on the Bank.

- *IFRS 1 First-time Adoption of International Financial Reporting Standards:* This improvement clarifies that an entity that stopped applying IFRS in the past and chooses, or is required, to apply IFRS, has the option to re-apply IFRS 1. If IFRS 1 is not re-applied, an entity must retrospectively restate its financial statements as if it had never stopped applying IFRS.
- *IAS 1 Presentation of Financial Statements*: This improvement clarifies the difference between voluntary additional comparative information and the minimum required comparative information. Generally, the minimum required comparative information is the previous period.
- *IAS 16 Property Plant and Equipment*: This improvement clarifies that major spare parts and servicing equipment that meet the definition of property, plant and equipment are not inventory.
- *IAS 32 Financial Instruments, Presentation*: This improvement clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with IAS 12 *Income Taxes.*

IAS 34 Interim Financial Reporting: The amendment aligns the disclosure requirements for total segment assets with total segment liabilities in interim financial statements. This clarification also ensures that interim disclosures are aligned with annual disclosures.

(Figures in Tables are in thousands of Azerbaijani Manats)

4. Significant accounting judgments and estimates

In the process of applying the Bank's accounting policies, management has made the following judgements and made estimates which have affected the amounts recognised in the consolidated financial statements:

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values.

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management interpretation of such legislation and changes, including the law allowing financial institutions to be exempt from payment of profit tax starting 1 January 2009 (for 3 consequent years) if the current year profit is capitalized, as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. As such, additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three years including the year of review. Management believes that as at 31 December 2012 its interpretation of the relevant legislation is appropriate and that the Bank's tax position will be sustained.

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its experienced judgement to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Bank uses its experienced judgement to adjust observable data for a group of loans or receivables to reflect current circumstances.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment. The valuations of collaterals are performed based on review of similar collaterals available on the market.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	31 December 2012	*31 December 2011*
Cash on hand	12,948	4,594
Current accounts with the Central Bank of the Republic of Azerbaijan	32,978	10,894
Current accounts with other credit institutions	22,600	13,870
Time deposits	–	5,747
Cash and cash equivalents	**68,526**	**35,105**

Current accounts with other credit institutions consist of interest bearing correspondent account balances with resident and non-resident banks in the amount of AZN 4,100 thousands (2011 – AZN 8,818 thousands) and AZN 18,500 thousands (2011 – AZN 5,052 thousands), respectively.

(Figures in Tables are in thousands of Azerbaijani Manats)

5. Cash and cash equivalents (continued)

As of 31 December 2012 the balance of time deposits placed with non-resident banks comprised nil (2011 – AZN 5,747 thousands placed with one non resident bank).

Non-cash transaction performed by the Bank during 2012 is represented by capitalization of net profit for the year 2011 (2011 – for the year 2010) to share capital in the amount of AZN 10,750 thousands (2011 – AZN 8,068 thousands) and capitalization of amount reserved for increase in share capital in the amount of AZN 2,645 thousands (2011 – nil).

6. Trading securities

Trading securities comprise:

	31 December 2012		*31 December 2011*	
	Annual interest rate	*Carrying value*	*Annual interest rate*	*Carrying value*
Corporate bonds issued by "Unileasing" Leasing Company CJSC	9.50%	4,915	9.50%–10.00%	1,017
Corporate bonds issued by Bank of Baku OJSC	12.00%	3,604	–	–
Corporate bonds issued by Bakcell LTD	9.50%	3,506	9.50%	9,682
Corporate bonds issued by Unibank Commercial Bank OJSC	11.00%	2,155	11.00%	9,784
Eurobonds of Akbank TAS	–	–	5.13%	3,010
Equity securities held by Citadele Banka JSC, external asset manager	–	–	–	720
T-bills of Hellenic Republic	–	–	4.30%	523
Trading securities		**14,180**		**24,736**

As of 31 December 2012 the Bank carried market maker service activities and signed related agreements with four (2011 – three) local entities. As of 31 December 2012 the Bank had trading securities under these agreements amounting to AZN 14,180 thousands (2011 – AZN 20,483 thousands).

7. Securities purchased under agreements to resell

As of 31 December 2012 balance of securities purchased under agreement to resell comprised of nil (2011 – AZN 26,932 thousands).

8. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	31 December 2012	*31 December 2011*
Obligatory reserve with the Central Bank of the Republic of Azerbaijan	11,270	4,983
Time deposits	3,690	19,697
Blocked deposits	–	4
Amounts due from credit institutions	**14,960**	**24,684**

As of 31 December 2012, AZN 3,225 thousands or 87% of total time deposits (2011 – AZN 16,353 thousands or 83% of total time deposits) was placed on inter-bank deposits with two local (2011 – two local and one non resident) commercial banks maturing through 12 April 2013 (2011 – through 21 May 2012) and with effective annual interest rate of 9%-12% (2011 – 6%-12%).

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR at 3% (2011 – 2% and 3%) of the previous month average of funds attracted from customers by the credit institution in local and foreign currency, respectively. The Bank's ability to withdraw such deposit is restricted by statutory legislation.

(Figures in Tables are in thousands of Azerbaijani Manats)

9. Investment securities available-for-sale

Investment securities available-for-sale comprises:

	31 December 2012		*31 December 2011*	
	Carrying value	***Nominal value***	***Carrying value***	***Nominal value***
Notes issued by the Azerbaijan Mortgage Fund	181,988	179,267	163,695	160,992
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	77,311	76,680	11,952	11,997
Treasury bills issued by the Ministry of Finance of the Republic of Azerbaijan	–	–	33,357	33,632
Notes issued by Baghlan Group FZCO	36,320	35,325	–	–
Notes issued by the Central Bank of the Republic of Azerbaijan	28,080	28,104	–	–
Corporate bonds issued by FinansLizinq Open Joint Stock Company (OJSC)	–	–	303	303
Investment securities available-for-sale	**323,699**	**319,376**	**209,307**	**206,924**

Nominal interest rates per annum and maturities of these securities are as follows:

	31 December 2012		*31 December 2011*	
	%	*Maturity*	*%*	*Maturity*
Notes issued by Azerbaijan Mortgage Fund	3.0%–3.25%	May 2016 – November 2022	3.0%–3.25%	May 2016 – December 2019
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	4.0% - 5.00%	June 2013 – July 2015	2.5% - 2.99%	February 2012 – May 2012
Treasury bills issued by the Ministry of Finance of the Republic of Azerbaijan	–	–	3.98% - 7.00%	March 2012 – December 2012
Notes issued by Baghlan Group FZCO	14.75%	June 2015	–	–
Notes issued by the Central Bank of the Republic of Azerbaijan	1.66% - 2.65%	January 2013	–	–
Corporate bonds issued by FinansLizinq Open Joint Stock Company (OJSC)	–	–	15.00%	December 2012

10. Loans to banks

As of 31 December 2012 the Bank had outstanding amount of AZN 1,000 thousands (2011 – AZN 1,500 thousands) of unsecured loan denominated in Azerbaijani Manat, issued to one resident commercial bank with contractual maturity through February 2013 (2011 – April 2012) and annual interest rate of 10.50% (2011 – 11%).

11. Loans to customers

Loans to customers comprise:

	31 December 2012	*31 December 2011*
Legal entities	262,616	241,970
Individuals	20,221	4,799
Loans to customers (gross)	**282,837**	**246,769**
Less – Allowance for impairment (Note 23)	(8,696)	(12,765)
Loans to customers (net)	**274,141**	**234,004**

(Figures in Tables are in thousands of Azerbaijani Manats)

11. Loans to customers (continued)

A reconciliation of the allowance for impairment of loans to customers by class is as follows:

	Corporate lending 31 December 2012	*Individual lending 31 December 2012*	*Total 31 December 2012*
Individual impairment	(6,069)	(478)	(6,547)
Collective impairment	(1,997)	(152)	(2,149)
	(8,066)	**(630)**	**(8,696)**
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	25,891	570	26,461

	Corporate lending 31 December 2011	*Individual lending 31 December 2011*	*Total 31 December 2011*
Individual impairment	(11,238)	(358)	(11,596)
Collective impairment	(1,103)	(66)	(1,169)
	(12,341)	**(424)**	**(12,765)**
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	13,836	442	14,278

Loans are made in the following industry sectors:

	31 December 2012	*31 December 2011*
Trade and services	130,646	111,430
Manufacturing	62,611	60,450
Construction	34,960	37,417
Individuals	20,221	4,799
Agriculture and food processing	15,862	6,861
Transport and telecommunication	12,698	5,336
Leasing	5,014	–
Energy	312	255
Hotel business	–	20,057
Other	513	164
Total loans (gross)	**282,837**	**246,769**

As of 31 December 2012, the Bank granted loans to 6 customers (2011 – 8 customers) totalling AZN 104,683 thousands (2011 – AZN 130,583 thousands), which individually exceeded 5% of the Bank's equity.

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For commercial lending, charges over real estate properties, inventory and trade receivables,
- For retail lending, mortgages over residential properties.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment.

(Figures in Tables are in thousands of Azerbaijani Manats)

12. Investment property

During 2011 the Bank acquired land for the amount of AZN 2,000 thousands as investment property which is held for long-term appreciation in value. As of 31 December 2012 the fair value of this investment property amounted to AZN 1,997 thousands (2011 – AZN 1,920 thousands).

13. Property and equipment

The movements in property and equipment were as follows:

	Buildings	*Furniture and fixtures*	*Computers and other equipment*	*Vehicles*	*Other equipment*	*Leasehold improve-ments*	*Construc-tion in progress*	*Total*
Cost								
31 December 2010	**2,151**	**1,100**	**868**	**426**	**37**	**108**	–	**4,690**
Additions	–	444	324	581	2	–	–	1,351
Disposals	–	(23)	(1)	(81)	(4)	–	–	(109)
31 December 2011	**2,151**	**1,521**	**1,191**	**926**	**35**	**108**	–	**5,932**
Additions	–	1,799	683	87	258	573	2,307	5,707
Disposals	–	(3)	–	(21)	–	–	–	(24)
Transfers	2,307	148	(148)	–	–	–	(2,307)	–
31 December 2012	**4,458**	**3,465**	**1,726**	**992**	**293**	**681**	–	**11,615**
Accumulated depreciation								
31 December 2010	–	**(478)**	**(398)**	**(227)**	**(15)**	**(23)**	–	**(1,141)**
Depreciation charge	–	(252)	(238)	(163)	(7)	(16)	–	(676)
Disposals	–	21	1	78	1	–	–	101
31 December 2011	**–**	**(709)**	**(635)**	**(312)**	**(21)**	**(39)**	–	**(1,716)**
Depreciation charge	(120)	(376)	(255)	(211)	(22)	(39)	–	(1,023)
Disposals	–	3	–	21	–	–	–	24
31 December 2012	**(120)**	**(1,082)**	**(890)**	**(502)**	**(43)**	**(78)**	–	**(2,715)**
Net book value:								
31 December 2012	4,338	2,383	836	490	250	603	–	8,900
31 December 2011	2,151	812	556	614	14	69	–	4,216

14. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Total*
Cost			
31 December 2010	**376**	**1,410**	**1,786**
Additions	24	436	460
31 December 2011	**400**	**1,846**	**2,246**
Additions	404	319	723
Disposals	(32)	–	(32)
31 December 2012	**772**	**2,165**	**2,937**
Accumulated amortization			
31 December 2010	(70)	(109)	(179)
Amortisation charge	(61)	(164)	(225)
31 December 2011	**(131)**	**(273)**	**(404)**
Amortisation charge	(25)	(262)	(287)
Disposals	32	–	32
31 December 2012	(124)	(535)	(659)
Net book value:			
31 December 2012	648	1,630	2,278
31 December 2011	269	1,573	1,842

(Figures in Tables are in thousands of Azerbaijani Manats)

15. Other assets and liabilities

Other assets comprise:

	31 December 2012	*31 December 2011*
Other financial assets		
Settlements on money transfers	123	206
Accrued interest receivable on guarantees and letters of credit	119	75
	242	281
Other non–financial assets		
Deferred expenses	5,911	418
Prepayments for acquisition of property, equipment and intangible assets	4,878	6,217
Receivable from the Ministry of Taxes	–	2,467
Other	360	59
	11,149	9,161
Other assets	**11,391**	**9,442**

As of 31 December 2012 deferred expenses of AZN 5,161 thousands, related to the long term prepayment for the rent of the service point located in Baku.

As of 31 December 2012 prepayments for the purchase of property, equipment and intangible assets of AZN 4,878 thousands (2011 – AZN 6,217 thousands) were related to premises for the Bank's new service points.

Other liabilities comprise:

	31 December 2012	*31 December 2011*
Other financial liabilities		
Accrued expenses	3,282	20
Settlements on money transfer	372	72
Payable to employees	284	195
Payables for professional services	259	56
Payables on social security costs	58	43
Accrued interest payables on letters of credit	17	12
Dividends payable (Note 21)	–	982
Other	1	1
	4,273	1,381
Other non–financial liabilities		
Accrued staff bonuses	1,146	1,525
Deferred income	394	482
Taxes, other than income tax	89	–
	1,629	2,007
Other liabilities	**5,902**	**3,388**

16. Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds

Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds comprise:

	31 December 2012	*31 December 2011*
Loans from the National Fund for Support of Entrepreneurship	28,753	19,971
Short-term deposits from banks	4,277	–
Amount due to Azerbaijan Mortgage Fund	1,478	921
Loans from the Central Bank of the Republic of Azerbaijan	535	10,000
Correspondent accounts with other banks	2	4
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	**35,045**	**30,896**

(Figures in Tables are in thousands of Azerbaijani Manats)

16. Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds (continued)

As of 31 December 2012 the Bank had twenty six loans (2011 – fourteen loans) from the National Fund for Support of Entrepreneurship amounting to AZN 28,753 thousands (2011 – AZN 19,971 thousands), maturing through February 2022 (2011 – through December 2016), and bearing annual interest rate of 1.0%. The loans were acquired for the purposes of assistance in gradually improving entrepreneurship environment in Azerbaijan under the government program. The loans have been granted to local entrepreneurs at 6%-7% annual interest rate (2011–6%-7%).

As of 31 December 2012 the Bank received short-term funds from one (2011 – nil) non resident commercial bank comprising AZN 4,277 thousands (2011 – nil) maturing through 21 January 2013 (2011 – none) and with effective annual interest rate of 0.65% (2011 – none).

As of 31 December 2012 the Bank had thirty five loans (2011 – twenty two) refinanced from the Azerbaijan Mortgage Fund amounting to AZN 1,478 thousands (2011 – AZN 921 thousands), maturing through May 2037 (2010 – through March 2036) and bearing annual interest rate of 4.0%.

As of 31 December 2012 the Bank had one loan (2011 – three loans) from the Central Bank of the Republic of Azerbaijan amounting to AZN 535 thousands (2011 – AZN 10,000 thousands), maturing through February 2013 (2011 – December 2012) and bearing annual interest rate of 6.00% (2011–2.5%-6.00%).

17. Amounts due to customers

The amounts due to customers include the following:

	31 December 2012	*31 December 2011*
Demand deposits	263,209	205,625
Time deposits	193,858	165,874
Amounts due to customers	**457,067**	**371,499**
Held as security against guarantees issued	**120**	**56**

An analysis of customer accounts by economic sector follows:

	31 December 2012	*31 December 2011*
Individuals	279,085	170,341
Investment holding companies	119,636	125,897
Trade and services	27,958	28,847
Construction	10,008	38,218
Insurance	7,461	2,414
Public organizations	3,919	–
Transport and communication	2,779	511
Manufacturing	2,235	2,873
Agriculture	536	684
Energy	1	32
Other	3,449	1,682
Amounts due to customers	**457,067**	**371,499**

As of 31 December 2012 customer deposits included balances with five largest customers amounting to AZN 347,917 thousands (2011 – AZN 262,902 thousands). These deposits comprise significant concentration of approximately 76% (2011 – 71%) of the total customer deposits portfolio.

As at 31 December 2012 time deposits amounting to AZN 120 thousands (2011 – AZN 56 thousands) were held as security against guarantees issued (Note 22).

(Figures in Tables are in thousands of Azerbaijani Manats)

18. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	31 December 2012	*31 December 2011*
Commerzbank Aktiengesellschaft	19,389	7,814
Raiffeisen Bank International Aktiengesellschaft	7,748	3,302
Landesbank Baden-Württemberg	3,798	2,991
Amounts due to credit institutions	**30,935**	**14,107**

As of 31 December 2012 amounts due to credit institutions included balances with three foreign banks amounting to AZN 30,935 thousands (2011 – AZN 14,107 thousands), maturing through 2021 (2011 – through 2012) and bearing annual interest rate of 1.91%-6.76% (2011–3.64%-6.94%) These unsecured borrowings are for trade finance of import operations (letters of credit) of the customers of the Bank.

19. Amount reserved for increase in share capital

Amount reserved for increase in share capital amounting to AZN 2,645 was capitalized during 2012.

20. Taxation

The corporate income tax expense comprises:

	Year ended 31 December 2012	*Year ended 31 December 2011*
Current tax charge	(3,029)	(1,031)
Deferred tax charge	(1,522)	(760)
Income tax expense	**(4,551)**	**(1,791)**

Deferred tax related to items credited to other comprehensive income during the year is as follows:

	Year ended 31 December 2012	*Year ended 31 December 2011*
Net (gains)/losses on investment securities available-for-sale	(47)	2
Income tax (charged)/credited to other comprehensive income	**(47)**	**2**

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	Year ended 31 December 2012	*Year ended 31 December 2011*
Profit before income tax expense	**20,762**	**15,150**
Statutory tax rate	20%	20%
Theoretical tax expense at the statutory rate	**(4,152)**	**(3,030)**
Tax effect of non–deductible expenses	(448)	(300)
Unrecognized deferred tax liabilities as result of capitalization	–	(671)
Tax effect of tax–exempt income arising from capitalization of profit	–	2,210
Other	49	–
Income tax expense	**(4,551)**	**(1,791)**

As of 31 December 2012 the Bank has current income tax receivable of nil (2011– current income tax receivable amounted to AZN 112 thousands).

(Figures in Tables are in thousands of Azerbaijani Manats)

20. Taxation (continued)

Deferred tax assets and liabilities as of 31 December and their movements for the respective years comprise:

		Origination and reversal of temporary differences			*Origination and reversal of temporary differences*		
	2010	*In the consolida-ted income statement*	*In other compre-hensive income*	*2011*	*In the consolida-ted income statement*	*In other compre-hensive income*	*2012*
Tax effect of deductible temporary differences:							
Investment securities available-for-sale	–	–	2	2	–	(2)	–
Loans to customers	–	148	–	148	24	–	172
Property and equipment	–	32	–	32	(32)	–	–
Other assets	–	–	–	–	12	–	12
Other liabilities	–	464	–	464	(15)	–	449
Deferred tax assets	**–**	**644**	**2**	**646**	**(11)**	**(2)**	**633**
Tax effect of taxable temporary differences:							
Trading securities	–	–	–	–	(208)	–	(208)
Amounts due from credit institutions	–	(59)	–	(59)	(105)	–	(164)
Investment securities available-for-sale	–	–	–	–	–	(45)	(45)
Loans to banks	–	(6)	–	(6)	2	–	(4)
Loans to customers	–	(891)	–	(891)	(1,055)	–	(1,946)
Property and equipment	–	–	–	–	(89)	–	(89)
Intangible assets	–	(20)	–	(20)	1	–	(19)
Provision for guarantees and letters of credit	–	(428)	–	(428)	(57)	–	(485)
Deferred tax liabilities	**–**	**(1,404)**	**–**	**(1,404)**	**(1,511)**	**(45)**	**(2,960)**
Net deferred tax liabilities	**–**	**(760)**	**2**	**(758)**	**(1,522)**	**(47)**	**(2,327)**

21. Equity

In 2011 share capital was increased by AZN 8,068 thousands from AZN 115,407 thousands to AZN 123,475 thousands through capitalization of the profit earned for the year ended 31 December 2010.

On 1 February 2012, the shareholders decided to increase the share capital by AZN 10,750 thousands through capitalization of the profit earned for the year ended 31 December 2011 and by AZN 2,645 thousands amount reserved for increase in share capital. As a result the share capital was increased from AZN 123,475 thousands to AZN 136,869 thousands.

On 17 April 2012, the shareholders of the Bank have decided to increase share capital of the Bank by additional cash contribution amounting of AZN 20,130 thousands. Increase of share capital has been finalized on 29 June 2012. The increase was carried out by converting 10,000 shares with a par value of AZN 13,686.94 into an equal number of shares with a par value of AZN 15,700.00.

On 5 December 2011, the shareholders of the Bank declared dividends of AZN 982 thousands from the 2011 net profit of the Bank. The dividends were paid to the shareholders of the Bank on 1 May 2012.

As of 31 December 2012, the Bank authorized, issued and fully paid capital amounted to AZN 157,000 thousands (31 December 2011 – AZN 123,475 thousands) comprising of 10,000 ordinary shares with a par value of AZN 15,700.00 per share (31 December 2011 – AZN 12,347.47). Each share entitles one vote to the shareholder.

22. Commitments and contingencies

Operating environment

As an emerging market, Azerbaijan does not possess a well-developed business and regulatory infrastructure that would generally exist in a more mature market economy. However, there have been a number of developments that positively affect the overall investment climate of the country.

While operations in Azerbaijan may involve risks that are not typically associated with those in developed markets (including the risk that the Azerbaijan Manat is not freely convertible outside of the country and undeveloped debt and equity markets), over the last few years the Azerbaijani government has made progress in implementing the reforms necessary to create banking, judicial, taxation and regulatory systems.

The existing tendency aimed at the overall improvement of the business environment is expected to persist. The future stability of the Azerbaijani economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government. However, the Azerbaijan economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The global financial crisis resulted in capital markets instability, deterioration of liquidity in the banking sector, and tighter credit conditions within Azerbaijan. The Azerbaijan Government has introduced a range of stabilization measures aimed at ensuring solvency and providing liquidity and supporting refinancing of foreign debt for Azerbaijan banks and companies.

While management believes it is taking appropriate measures to support the sustainability of the Bank's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Bank's results and consolidated statement of financial position in a manner not currently determinable.

Legal

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Bank.

Taxation

Azerbaijani tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. Recent events within the Azerbaijan suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years proceeding the year of review.

Management believes that its interpretation of the relevant legislation as of 31 December 2012 is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Insurance

The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions. Liability insurance is generally not available in Azerbaijan at present.

Financial commitments and contingencies

The Bank provides guarantees and letters of credit to customers with primary purpose of ensuring that funds are available to a customer as required. Guarantees and standby letters of credit represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorizing a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralized by the underlying shipments of goods, to which they relate, or cash deposits and, therefore, carry less risk than a direct borrowing.

(Figures in Tables are in thousands of Azerbaijani Manats)

22. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

Financial commitments and contingencies comprise:

	31 December 2012	*31 December 2011*
Credit–related commitments		
Guarantees issued	54,794	16,526
Unused credit lines	36,582	27,061
Letters of credit	15,919	13,056
	107,295	**56,643**
Operating lease commitments		
Not later than 1 year	279	276
Later than 1 year but not later than 5 years	1,415	983
Later than 5 years	300	600
	1,994	**1,859**
Less – Provisions (Note 23)	(967)	(1,404)
Commitments and contingencies (before deducting collateral)	**108,322**	**57,098**
Less – Cash held as security against guarantees issued (Note 17)	(120)	(56)
Commitments and contingencies	**108,202**	**57,042**

23. Impairment losses on interest bearing assets, and provision for guarantees and letters of credit

The movements in allowance for impairment losses on interest bearing assets, and provision for guarantees and letters of credit were as follows:

	Year ended 31 December 2012				
	Corporate lending	*Individual lending*	*Total loans to customers*	*Investment securities held to maturity*	*Guarantees and letters of credit*
At 1 January	**(12,341)**	**(424)**	**(12,765)**	**–**	**(1,404)**
(Charge)/reversal for the year	(7,132)	(206)	(7,338)		437
Amounts written off	11,407	–	11,407	–	–
At 31 December	**(8,066)**	**(630)**	**(8,696)**	**–**	**(967)**

	Year ended 31 December 2011				
	Corporate lending	*Individual lending*	*Total loans to customers*	*Investment securities held to maturity*	*Guarantees and letters of credit*
At 1 January	**(7,836)**	**(377)**	**(8,213)**	**(10)**	**(1,582)**
(Charge)/reversal for the year	(4,505)	(47)	(4,552)	10	178
At 31 December	**(12,341)**	**(424)**	**(12,765)**	**–**	**(1,404)**

Allowance for impairment of assets is deducted from the carrying amount of the related assets. Provision for guarantees and letters of credit is recorded in liabilities.

(Figures in Tables are in thousands of Azerbaijani Manats)

24. Net fee and commission income

Net fee and commission income comprise:

	Year ended 31 December 2012	*Year ended 31 December 2011*
Guarantees and letters of credit	2,338	1,670
Settlements operations	940	850
Cash operations	866	531
Servicing plastic card operations	712	298
Securities operations	514	495
Other	23	2
Fee and commission income	**5,393**	**3,846**
Servicing plastic card operations	(764)	(304)
Guarantees and letters of credit	(635)	(579)
Settlements operations	(326)	(262)
Securities operations	(113)	(237)
Cash operations	(8)	(6)
Other	(4)	(12)
Fee and commission expense	**(1,850)**	**(1,400)**
Net fee and commission income	**3,543**	**2,446**

25. Personnel, general and administrative expenses

Personnel expenses comprise:

	Year ended 31 December 2012	*Year ended 31 December 2011*
Salaries and bonuses	(5,063)	(4,230)
Social security costs	(1,092)	(1,029)
Other employee related expenses	(1,283)	(851)
Total personnel expenses	**(7,438)**	**(6,110)**

General and administrative expenses comprise:

	Year ended 31 December 2012	*Year ended 31 December 2011*
Professional services	(1,696)	(1,033)
Charity and sponsorship	(1,246)	(1,140)
Operating leases	(991)	(278)
Advertising costs	(942)	(526)
Software cost	(475)	(341)
Transportation and business trip expenses	(307)	(446)
Insurance	(187)	(157)
Stationery	(115)	(46)
Communications	(109)	(99)
Security expenses	(109)	(90)
Repair and maintenance	(103)	(51)
Utilities	(93)	(49)
Taxes, other than income tax	(77)	(48)
Membership fees	(29)	(24)
Printing expenses	(19)	(23)
Other expenses	(233)	(161)
Total general and administrative expenses	**(6,731)**	**(4,512)**

(Figures in Tables are in thousands of Azerbaijani Manats)

26. Risk management

Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

Risk management structure

The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles.

Audit Committee

The Audit Committee has the overall responsibility for the establishment and development of the audit mission and strategy. It is responsible for the fundamental audit issues and monitoring Internal Audit's activities.

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Bank.

Risk Committee

The Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions

Risk Management

The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure an independent control process.

Bank Treasury

Bank Treasury is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank.

Internal Audit

Risk management processes throughout the Bank are audited annually by the internal audit function, which examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

(Figures in Tables are in thousands of Azerbaijani Manats)

26. Risk management (continued)

Introduction (continued)

Risk measurement and reporting systems

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risks types and activities.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Management Board, the Risk Committee, and the head of each business division. The report includes aggregate credit exposure, hold limit exceptions and liquidity ratios. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Board of Directors receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Bank.

For all levels throughout the Bank, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

A daily briefing is given to the Management Board and all other relevant employees of the Bank on the utilisation of market limits and liquidity, plus any other risk developments.

Risk mitigation

Bank actively uses collateral to reduce its credit risks.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risks, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit and customer's deposit risks are controlled and managed accordingly.

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

(Figures in Tables are in thousands of Azerbaijani Manats)

26. Risk management (continued)

Credit risk (continued)

Credit-related commitments risks

The Bank makes available to its customers guarantees which may require that the Bank make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies.

The maximum exposure to credit risk for the components of the consolidated statement of financial position, including derivatives, before the effect of mitigation through the use of master netting and collateral agreements, is best represented by their carrying amounts.

Where financial instruments are recorded at fair value, the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

For more details on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes.

As of 31 December 2012 the Bank had two (2011 – nil) deposit placements with a local bank in the amount of AZN 10,204 thousands each and the same counterparty bank had two placements with the Bank for USD 13,000 thousands each. Annual interest rate for placements made and deposits received comprised of 3% and 4.75%, respectively. All contracts matured in February 2013. These placements represent currency swaps which were netted off for presentation purposes in the consolidated statement of financial position as of 31 December 2012.

As of 31 December 2012 the Bank had two (2011 – nil) deposit placements with a local bank in the total amount of AZN 9,892 thousands and the same counterparty bank had two placements with the Bank for the total amount of USD 12,600 thousands. Annual interest rate for placements made and deposits received comprised of 5%. All contracts matured in January 2013. These placements represent currency swaps which were netted off for presentation purposes in the consolidated statement of financial position as of 31 December 2012.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank internal credit ratings. The table below shows the credit quality by class of asset for loan-related consolidated statement of financial position lines, based on the Bank's credit rating system.

		Neither past due nor impaired					
	Notes	*High grade 2012*	*Standard grade 2012*	*Sub-standard grade 2012*	*Past due but not impaired 2012*	*Individually impaired 2012*	*Total 2012*
Amounts due from credit institutions	8	–	14,960	–	–	–	14,960
Investment securities available-for-sale	9	287,379	36,320	–	–	–	323,699
Loans to banks	10	–	1,000	–	–	–	1,000
Loans to customers	11						
Corporate lending		236,725	–	–	–	25,891	262,616
Individual lending		19,651	–	–	–	570	20,221
Total		**543,755**	**52,280**	**–**	**–**	**26,461**	**622,496**

(Figures in Tables are in thousands of Azerbaijani Manats)

26. Risk management (continued)

Credit risk (continued)

	Notes	*Neither past due nor impaired* High grade 2011	Standard grade 2011	Sub-standard grade 2011	*Past due but not impaired 2011*	*Individually impaired 2011*	*Total 2011*
Securities purchased under agreements to resell	7	26,932	–	–	–	–	26,932
Amounts due from credit institutions	8	–	24,684	–	–	–	24,684
Investment securities available-for-sale	9	209,004	303	–	–	–	209,307
Loans to banks	10	–	1,500	–	–	–	1,500
Loans to customers	11						
Corporate lending		228,134	–	–	–	13,836	241,970
Individual lending		4,357	–	–	–	442	4,799
Total		**468,427**	**26,487**	**–**	**–**	**14,278**	**509,192**

The Bank classifies its loan related assets as follows:

High grade – counterparties with excellent financial performance, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.

Standard grade – counterparties with stable financial performance, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.

Sub-Standard grade – counterparties with satisfactory financial performance, having changes in the terms and conditions of loan agreements and no overdue in principal and interest.

Past due but not impaired – counterparties with satisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.

Individually impaired – counterparties with satisfactory and unsatisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The attributable risk ratings are assessed and updated regularly.

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

(Figures in Tables are in thousands of Azerbaijani Manats)

26. Risk management (continued)

Credit risk (continued)

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans to customers that are not individually significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the appropriate delay between the time a loss is likely to have been uncured and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. Local management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for loans.

The geographical concentration of the Bank's monetary assets and liabilities is set out below:

	31 December 2012				*31 December 2011*			
	The Republic of Azerbaijan	*OECD countries*	*CIS and other non-OECD countries*	*Total*	*The Republic of Azerbaijan*	*OECD countries*	*CIS and other non-OECD countries*	*Total*
Financial assets:								
Cash and cash equivalents	50,026	1,801	16,699	68,526	24,323	10,707	75	35,105
Trading securities	14,180	–	–	14,180	20,483	4,226	27	24,736
Securities purchased under repurchase agreements	–	–	–	–	26,932	–	–	26,932
Amounts due from credit institutions	14,622	338	–	14,960	19,662	336	4,686	24,684
Investment securities available-for-sale	287,379	–	36,320	323,699	209,307	–	–	209,307
Loans to banks	1,000	–	–	1,000	1,500	–	–	1,500
Loans to customers	266,923	–	7,218	274,141	234,004	–	–	234,004
Other financial assets	242	–	–	242	174	107	–	281
	634,372	**2,139**	**60,237**	**696,748**	**536,385**	**15,376**	**4,788**	**556,549**
Financial liabilities:								
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	30,894	–	4,151	35,045	30,896	–	–	30,896
Amounts due to customers	457,067	–	–	457,067	371,499	–	–	371,499
Amounts due to credit institutions	–	30,935	–	30,935	–	14,107	–	14,107
Other financial liabilities	4,235	38	–	4,273	1,366	15	–	1,381
Amount reserved for increase in share capital	–	–	–	–	2,645	–	–	2,645
	492,196	**30,973**	**4,151**	**527,320**	**406,406**	**14,122**	**–**	**420,528**
Net assets	**142,176**	**(28,834)**	**56,086**	**169,428**	**129,979**	**1,254**	**4,788**	**136,021**

(Figures in Tables are in thousands of Azerbaijani Manats)

26. Risk management (continued)

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. In addition, the Bank maintains obligatory reserves with the CBAR, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank based on certain liquidity ratios established by the CBAR. As at 31 December 2012 and 2011 these ratios were as follows:

	31 December 2012, %	*31 December 2011, %*
Instant Liquidity Ratio (30% is the minimum required by CBAR) (assets receivable or realisable within one day/liabilities repayable on demand)	114	125

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2012 and 2011 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

Financial liabilities As at 31 December 2012	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total 2011*
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	6,124	4,996	19,323	5,974	36,417
Amounts due to customers	372,670	72,709	13,511	–	458,890
Amounts due to credit institutions	9,382	12,298	8,479	2,037	32,196
Other financial liabilities	3,933	340	–	–	4,273
Total undiscounted financial liabilities	**392,109**	**90,343**	**41,313**	**8,011**	**531,776**

Financial liabilities As at 31 December 2011	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total 2011*
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	3,485	10,131	17,547	1,094	32,257
Amounts due to customers	300,805	53,831	24,527	–	379,163
Amounts due to credit institutions	6,331	8,018	–	–	14,349
Other financial liabilities	159	1,222	–	–	1,381
Amount reserved for increase in share capital	2,645	–	–	–	2,645
Total undiscounted financial liabilities	**313,425**	**73,202**	**42,074**	**1,094**	**429,795**

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies.

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Maturity undefined*	*Total*
As of 31 December 2012	49,153	33,595	7,277	17,270	**107,295**
As of 31 December 2011	31,648	19,844	5,151	–	**56,643**

26. Risk management (continued)

Liquidity risk and funding management (continued)

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The Bank's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant concentration of deposits from organizations of related parties in the period of one year. Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank. Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than three months in the tables above.

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. The Bank manages exposures to market risk based of sensitivity analysis. The Bank has no significant concentration of market risk.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's current year profit.

The sensitivity of current year profit is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2012. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2012 for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve. However, as interest rate of available-for-sale securities in the local market is based on the carried accrued discount or premiums on these securities at the time of purchase or sale (as included in actual price of purchased or sold securities), thus, any change in the rates to be applied to the fixed-rate available-for-sale financial assets does not have any impact or effect on equity.

Currency risk

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

The Assets and Liabilities Management Committee controls currency risk by management of the open currency position on the estimated basis of AZN devaluation and other macroeconomic indicators, which gives the Bank an opportunity to minimize losses from significant currency rates fluctuations toward its national currency The Treasury Department performs daily monitoring of the Bank's open currency position with the aim to match the requirements of CBAR.

(Figures in Tables are in thousands of Azerbaijani Manats)

26. Risk management (continued)

Currency risk (continued)

As at 31 December 2012 the Bank had the following exposure to foreign currency exchange rate risk:

	AZN	USD	EUR	Other	Total 2012
Financial assets					
Cash and cash equivalents	38,584	9,304	3,422	17,216	68,526
Trading securities	14,180	–	–	–	14,180
Amounts due from credit institutions	12,013	2,845	102	–	14,960
Investment securities available-for-sale	287,379	36,320	–	–	323,699
Loans to banks	1,000	–	–	–	1,000
Loans to customers	198,251	31,178	44,712	–	274,141
Other financial assets	92	34	113	3	242
Total financial assets	**551,499**	**79,681**	**48,349**	**17,219**	**696,748**
Financial liabilities					
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	30,766	2	4,277	–	35,045
Amounts due to customers	402,070	30,954	23,957	86	457,067
Amounts due to credit institutions	–	12,254	18,681	–	30,935
Other financial liabilities	3,950	193	128	2	4,273
Total financial liabilities	**436,786**	**43,403**	**47,043**	**88**	**527,320**
Net financial position	**114,713**	**36,278**	**1,306**	**17,131**	**169,428**

As at 31 December 2011 the Bank had the following exposure to foreign currency exchange rate risk:

	AZN	USD	EUR	Other	Total 2011
Financial assets					
Cash and cash equivalents	13,683	14,660	1,755	5,007	35,105
Trading securities	20,483	3,382	834	37	24,736
Securities purchased under agreements to resell	26,932	–	–	–	26,932
Amounts due from credit institutions	7,776	2,455	14,453	–	24,684
Investment securities available-for-sale	209,307	–	–	–	209,307
Loans to banks	1,500	–	–	–	1,500
Loans to customers	193,709	23,815	16,480	–	234,004
Other financial assets	71	30	179	1	281
Total financial assets	**473,461**	**44,342**	**33,701**	**5,045**	**556,549**
Financial liabilities					
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	30,892	3	1	–	30,896
Amounts due to customers	307,409	39,583	24,496	11	371,499
Amounts due to credit institutions	–	5,114	8,993	–	14,107
Other financial liabilities	1,329	41	11	–	1,381
Amount reserved for increase in share capital	2,645	–	–	–	2,645
Total financial liabilities	**342,275**	**44,741**	**33,501**	**11**	**420,528**
Net financial position	**131,186**	**(399)**	**200**	**5,034**	**136,021**

(Figures in Tables are in thousands of Azerbaijani Manats)

26. Risk management (continued)

Currency risk (continued)

Currency risk sensitivity

The following table details the Bank's sensitivity to a 10% increase and decrease in the USD and EUR against the AZN. 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 currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Bank where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

Impact on profit before tax based on assets value as at 31 December 2012 and 2011:

	31 December 2012		31 December 2011	
	AZN/USD +10%	**AZN/USD -10%**	**AZN/USD +10%**	**AZN/USD -10%**
Impact on profit before tax	(3,628)	3,628	40	(40)

	31 December 2012		31 December 2011	
	AZN/EUR +10%	**AZN/EUR -10%**	**AZN/EUR +10%**	**AZN/EUR -10%**
Impact on profit before tax	(130)	130	(20)	20

27. Fair values of financial instruments

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

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

At 31 December 2012	*Level 1*	*Level 2*	*Level 3*	*Total*
Financial assets				
Trading securities	14,180	–	–	14,180
Investment securities available-for-sale	323,699	–	–	323,699
	337,879	–	–	**337,879**

At 31 December 2011	*Level 1*	*Level 2*	*Level 3*	*Total*
Financial assets				
Trading securities	24,213	523	–	24,736
Investment securities available-for-sale	209,307	–	–	209,307
	233,520	**523**	–	**234,043**

(Figures in Tables are in thousands of Azerbaijani Manats)

27. Fair values of financial instruments (continued)

Financial instruments recorded at fair value

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Bank's estimate of assumptions that a market participant would make when valuing the instruments.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity. For quoted debt issued the fair values are calculated based on quoted market prices. For those notes issued where quoted market prices are not available, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term to maturity.

Fair value of financial assets and liabilities not carried at fair value

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the consolidated statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2012	*Fair value 2012*	*Unrecognized gain/(loss) 2012*	*Carrying value 2011*	*Fair value 2011*	*Unrecognized gain/(loss) 2011*
Financial assets						
Cash and cash equivalents	68,526	68,526	–	35,105	35,105	–
Amounts due from credit institutions	14,960	14,960	–	24,684	24,684	–
Loans to banks	1,000	1,000	–	1,500	1,500	–
Loans to customers	274,141	274,141	–	234,004	234,004	–
Investment property	2,000	1,997	(3)	2,000	1,920	(80)
Financial liabilities						
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	35,045	35,045	–	30,896	30,896	–
Amounts due to customers	457,067	457,067	–	371,499	371,499	–
Amounts due to credit institutions	30,935	30,935	–	14,107	14,107	–
Total unrecognised change in unrealised fair value			**(3)**			**(80)**

Assets for which fair value approximates carrying value

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

Fixed and variable rate financial instruments

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

(Figures in Tables are in thousands of Azerbaijani Manats)

28. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled See Note 26 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	31 December 2012			*31 December 2011*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	68,526	–	68,526	35,105	–	35,105
Trading securities	4,915	9,265	14,180	24,736	–	24,736
Securities purchased under agreements to resell	–	–	–	26,932	–	26,932
Amounts due from credit institutions	14,960	–	14,960	24,684	–	24,684
Investment securities available-for-sale	106,550	217,149	323,699	46,419	162,888	209,307
Loans to banks	1,000		1,000	1,500	–	1,500
Loans to customers	139,827	134,314	274,141	131,657	102,347	234,004
Investment property	–	2,000	2,000	–	2,000	2,000
Property and equipment	–	8,900	8,900	–	4,216	4,216
Intangible assets	–	2,278	2,278	–	1,842	1,842
Current income tax assets	–	–	–	112	–	112
Other assets	7,222	4,169	11,391	6,975	2,467	9,442
Total assets	**343,000**	**378,075**	**721,075**	**298,120**	**275,760**	**573,880**
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	4,923	30,122	35,045	12,812	18,084	30,896
Amounts due to customers	442,247	14,820	457,067	349,005	22,494	371,499
Amounts due to credit institutions	21,229	9,706	30,935	14,107	–	14,107
Current income tax liabilities	484	–	484	–	–	–
Deferred income tax liabilities	2,327	–	2,327	758	–	758
Provision for guarantees and letters of credit	967	–	967	1,404	–	1,404
Other liabilities	5,857	45	5,902	3,343	45	3,388
Amount reserved for increase in share capital	–	–	–	2,645	–	2,645
Total liabilities	**478,034**	**54,693**	**532,727**	**384,074**	**40,623**	**424,697**
Net	**(135,034)**	**323,382**	**188,348**	**(85,954)**	**235,137**	**149,183**

Negative gap will not affect the Bank's liquidity position considering high liquidity of available-for-sale securities (securities issued by Azerbaijan Mortgage Fund, classified as noncurrent).

Long-term loans are generally not available in Azerbaijan except for programs set up by the Azerbaijan Government and international financial institutions. In addition, the maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due on demand in the tables above. While trading securities are shown at demand, realizing such assets upon demand is dependent upon financial market conditions. Significant security positions may not be liquidated in a short period of time without adverse price effects.

(Figures in Tables are in thousands of Azerbaijani Manats)

29. Related party disclosures

In accordance with IAS 24 "Related Party Disclosures", parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

	31 December 2012					*31 December 2011*				
	Parent	*Entities under common control*	*Key management personnel*	*Other*	*Total*	*Parent*	*Entities under common control*	*Key management personnel*	*Other*	*Total*
Loans outstanding at 1 January, gross	16	21,904	299	–	**22,219**	–	21,242	234	–	**21,476**
Accrued interest income at 1 January	–	85	5	–	**90**	–	85	2	–	**87**
Loans issued during the year	4	8,092	709	4	**8,809**	16	1,724	547	–	**2,287**
Loan repayments during the year	–	(21,245)	(542)	(4)	**(21,791)**	–	(1,147)	(484)	–	**(1,631)**
Interest accrual	3	36	4	–	**43**	–	85	5	–	**90**
Loans outstanding at 31 December, gross	**23**	**8,872**	**475**	**–**	**9,370**	**16**	**21,989**	**304**	**–**	**22,309**
Less: allowance for impairment at 31 December	–	(64)	(3)	–	**(67)**	–	(192)	(5)	–	**(197)**
Loans outstanding at 31 December, net	**23**	**8,808**	**472**	**–**	**9,303**	**16**	**21,797**	**299**	**–**	**22,112**
Interest income on loans	2	3,519	37	–	**3,558**	1	2,548	27	–	**2,576**

(Figures in Tables are in thousands of Azerbaijani Manats)

29. Related party disclosures (continued)

	31 December 2012					31 December 2011				
	Parent	*Entities under common control*	*Key management personnel*	*Other*	*Total*	*Parent*	*Entities under common control*	*Key management personnel*	*Other*	*Total*
Deposits at 1 January	47,560	7,000	375	62,593	**117,528**	52,701	6,800	301	50,691	**110,493**
Accrued interest expense at 1 January	–	–	–	–	–	–	–	–	–	–
Deposits received during the year	15,200	6,114	–	174,231	**195,545**	40,200	13,800	76	78,681	**132,757**
Deposits repaid during the year	(15,205)	(7,914)	(1)	(145,031)	**(168,151)**	(45,341)	(13,600)	(2)	(66,779)	**(125,722)**
Interest accrual	63	30	–	148	**241**	–	–	–	–	–
Deposits at 31 December	**47,618**	**5,230**	**374**	**91,941**	**145,163**	**47,560**	**7,000**	**375**	**62,593**	**117,528**
Current accounts at 31 December	7,139	54,841	219	166,900	**229,099**	5,339	61,162	77	84,363	**150,941**
Interest expense on deposits	(3,872)	(409)	(35)	(4,105)	**(8,421)**	(3,802)	(471)	(28)	(2,732)	**(7,033)**
Guarantees issued	–	35	–	–	**35**	–	32	–	–	**32**
Letters of credit issued	–	36	–	–	**36**	–	–	–	–	–
Unused credit lines	71	6,139	118	15	**6,343**	75	340	100	15	**530**
Fee and commission income	45	623	1	49	**718**	21	756	1	60	**838**
Other operating expenses	–	(817)	–	(70)	**(887)**	–	(413)	–	(70)	**(483)**

Compensation of key management personnel was comprised of the following:

	Year ended 31 December 2012	*Year ended 31 December 2011*
Salaries and other benefits	(1,804)	(1,455)
Social security costs	(351)	(320)
Total key management compensation	**(2,155)**	**(1,775)**

30. Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the ratios established by the CBAR.

During the past year, the Bank had complied in full with all its externally imposed capital requirements.

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

(Figures in Tables are in thousands of Azerbaijani Manats)

30. Capital adequacy (continued)

CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum capital adequacy ratio of 12% of risk-weighted assets for regulatory capital. As of 31 December 2012 and 2011 the Bank's capital adequacy ratio on this basis was as follows:

	31 December 2012	*31 December 2011*
Tier 1 capital	165,809	131,301
Tier 2 capital	18,403	15,944
Less: Deductions from capital	(18,893)	(1,841)
Total regulatory capital	**165,319**	**145,404**
Risk-weighted assets	**490,752**	**337,840**
Capital adequacy ratio	34%	43%