

OJSC PASHA Bank

Interim condensed consolidated financial statements

30 June 2014

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Report on review of interim condensed consolidated financial statements

To the Shareholders and Board of Directors of OJSC PASHA Bank

We have reviewed the accompanying interim condensed consolidated financial statements of OJSC PASHA Bank and its subsidiary, which comprise the interim condensed consolidated statement of financial position as at 30 June 2014 and the related interim condensed consolidated income statement and interim condensed consolidated statements of comprehensive income, changes in equity and cash flows for the six-month period then ended and selected explanatory notes.

Management is responsible for the preparation and presentation of these interim condensed consolidated financial statements in accordance with International Financial Reporting Standard IAS 34, *Interim Financial Reporting* ("IAS 34"). Our responsibility is to express a conclusion on these interim condensed consolidated financial statements based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*.

A review of interim condensed consolidated financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with IAS 34 *Interim Financial Reporting*.

Ernst & Young Holdings (CIS) B.V.

23 September 2014

INTERIM CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION**As at 30 June 2014***(Figures in tables are in thousand of Azerbaijani manats)*

	Notes	30 June 2014 (unaudited)	31 December 2013
Assets			
Cash and cash equivalents	4	151,400	48,056
Trading securities	5	46,135	51,717
Securities purchased under agreements to resell		1,204	—
Amounts due from credit institutions	6	58,176	32,639
Investment securities available-for-sale	7	289,496	156,126
Loans to banks	8	5,072	14,107
Loans to customers	9	372,008	329,218
Investment property	10	2,000	2,000
Property and equipment	11	16,739	14,389
Prepayment for equity investment		41,971	41,971
Intangible assets	12	4,129	3,989
Other assets	13	9,674	9,843
Total assets		998,004	704,055
Liabilities			
Amounts due to banks and government funds	14	159,449	107,286
Amounts due to customers	15	449,188	302,817
Amounts due to credit institutions	16	42,344	37,252
Current income tax liabilities		—	1,562
Deferred income tax liabilities		1,349	1,969
Provision for guarantees and letters of credit	20	644	150
Dividends payable to shareholders	18	—	14,992
Other liabilities	13	2,710	3,104
Total liabilities		655,684	469,132
Equity			
Share capital	18	333,000	228,000
Retained earnings		10,198	7,699
Net unrealised gains/(losses) on investment securities available-for-sale		651	(44)
Foreign currency translation reserve		(1,529)	(732)
Total equity		342,320	234,923
Total liabilities and equity		998,004	704,055

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

Farid Akhundov

Farid Akhundov

Chairman of the Executive Board

Elmina Nabiyeva



Director of Financial Management Department

23 September 2014

The accompanying notes on pages 6 to 23 are an integral part of these interim condensed consolidated financial statements.

INTERIM CONDENSED CONSOLIDATED INCOME STATEMENT**For the six months ended 30 June 2014***(Figures in tables are in thousand of Azerbaijani manats)*

	<i>Notes</i>	<i>2014 (6 months) (unaudited)</i>	<i>2013 (6 months) (unaudited)</i>
Interest income			
Loans to customers		21,439	18,743
Investment securities available-for-sale		4,894	6,953
Trading securities		2,008	748
Amounts due from credit institutions		1,080	1,081
Loans to banks		615	70
Securities purchased under agreements to resell		63	52
		30,099	27,647
Interest expense			
Amounts due to customers		(4,050)	(4,762)
Amounts due to credit institutions		(829)	(952)
Amounts due to banks and government funds		(1,997)	(596)
		(6,876)	(6,310)
Net interest income		23,223	21,337
Provision for impairment losses on interest bearing assets	20	(9,439)	(7,574)
Net interest income after provision for impairment losses		13,784	13,763
Net fee and commission income	21	1,495	1,562
Net gains from trading securities		110	196
Net (losses)/gains from investment securities available-for-sale		(115)	67
Net gains/(losses) from foreign currencies:			
- dealing		2,662	2,838
- translation differences		20	(111)
Other income		19	61
Non-interest income		4,191	4,613
Personnel expenses	22	(5,789)	(5,489)
General and administrative expenses	22	(5,989)	(3,629)
Depreciation and amortisation	11,12	(1,765)	(1,074)
Provision for guarantees and letters of credit	20	(494)	(185)
Non-interest expenses		(14,037)	(10,377)
Profit before income tax expense		3,938	7,999
Income tax expense	17	(1,439)	(2,509)
Net profit for the period		2,499	5,490

The accompanying notes on pages 6 to 23 are an integral part of these interim condensed consolidated financial statements.

INTERIM CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**For the six months ended 30 June 2014***(Figures in tables are in thousand of Azerbaijani manats)*

	<i>Notes</i>	2014 (6 months) (unaudited)	2013 (6 months) (unaudited)
Net profit for the period		2,499	5,490
Other comprehensive income			
<i>Other comprehensive income to be reclassified to profit or loss in subsequent periods:</i>			
Gross unrealised gains/(losses) on investment securities available-for-sale		984	(808)
Realised (losses)/gains on investment securities available-for-sale reclassified to the consolidated statement of profit or loss		(115)	67
Net unrealised gains/ (losses) in investment securities available-for-sale		869	(741)
Tax effect of net gains/(losses) on investment securities available-for-sale	17	(174)	148
Foreign currency translation difference net of tax		(797)	(3)
Net other comprehensive loss to be reclassified to profit or loss in subsequent periods		(102)	(596)
Total comprehensive income for the period		2,397	4,894

The accompanying notes on pages 6 to 23 are an integral part of these interim condensed consolidated financial statements.

INTERIM CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**For the six months ended 30 June 2014***(Figures in tables are in thousand of Azerbaijani manats)*

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Net unrealised gain/(losses) on investment securities available-for- sale</i>	<i>Foreign currency translation difference</i>	<i>Total equity</i>
As at 31 December 2012	157,000	31,178	181	(11)	188,348
Net profit for the six months ended 30 June 2013 (unaudited)	–	5,490	–	–	5,490
Other comprehensive loss for the six months ended 30 June 2013 (unaudited)	–	–	(593)	(3)	(596)
Total comprehensive income for the six months ended 30 June 2013 (unaudited)	–	5,490	(593)	(3)	4,894
Dividends paid (Note 18)	–	(20,515)	–	–	(20,515)
Cash contribution for share capital increase (Note 18)	21,000	–	–	–	21,000
As at 30 June 2013 (unaudited)	178,000	16,153	(412)	(14)	193,727
As at 31 December 2013	228,000	7,699	(44)	(732)	234,923
Net profit for the six months ended 30 June 2014 (unaudited)	–	2,499	–	–	2,499
Other comprehensive income for the six months ended 30 June 2014 (unaudited)	–	–	695	(797)	(102)
Total comprehensive loss for the six months ended 30 June 2014 (unaudited)	–	2,499	695	(797)	2,397
Cash contribution for share capital increase (Note 18)	105,000	–	–	–	105,000
As at 30 June 2014 (unaudited)	333,000	10,198	651	(1,529)	342,320

The accompanying notes on pages 6 to 23 are an integral part of these interim condensed consolidated financial statements.

INTERIM CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**For the six months ended 30 June 2014***(Figures in tables are in thousand of Azerbaijani manats)*

	<i>Notes</i>	2014 (6 months) (unaudited)	2013 (6 months) (unaudited)
Cash flows from operating activities			
Interest received		28,519	23,667
Interest paid		(6,749)	(6,084)
Fees and commissions received		2,822	2,884
Fees and commissions paid		(1,374)	(1,432)
Net realized (losses)/gains on sale of investment securities available-for-sale		(115)	67
Net realized losses from trading securities		110	(38)
Realised gains less losses from dealing in foreign currencies		2,662	2,838
Personnel expenses paid		(5,965)	(5,629)
General and administrative expenses paid		(5,627)	(6,811)
Other operating income received		19	62
Cash flows from operating activities before changes in operating assets and liabilities		14,302	9,524
<i>Net (increase)/decrease in operating assets</i>			
Trading securities		5,401	(13,891)
Amounts due from credit institutions		(25,761)	(1,511)
Loans to banks		12,813	(3,000)
Loans to customers		(52,483)	(45,014)
Other assets		(232)	(341)
<i>Net increase/(decrease) in operating liabilities</i>			
Amounts due to banks and government funds		47,767	(1,483)
Amounts due to customers		146,791	(96,274)
Amounts due to credit institutions		5,162	30,570
Other liabilities		(152)	3,083
Net cash from/(used in) operating activities before income tax		153,608	(118,337)
Income tax paid		(3,217)	(1,966)
Net cash from/(used in) operating activities		150,391	(120,303)
Cash flows from investing activities			
Purchase of securities under agreements to resell		(1,204)	–
Proceeds from sale and redemption of investment securities available-for-sale		131,099	172,768
Purchases of investment securities available-for-sale		(262,783)	(49,111)
Purchase of property and equipment and intangible assets		(4,259)	(2,019)
Proceeds from sale of property and equipment		–	47
Net cash (used in)/from investing activities		(137,147)	121,685
Cash flows from financing activities			
Issue of ordinary share capital	18	105,000	21,000
Dividends paid	18	(14,992)	(20,515)
Net cash from financing activities		90,008	485
Effect of exchange rates changes on cash and cash equivalents		92	(112)
Net increase in cash and cash equivalents		103,344	1,755
Cash and cash equivalents, beginning	4	48,056	68,526
Cash and cash equivalents, ending	4	151,400	70,281

The accompanying notes on pages 6 to 23 are an integral part of these interim condensed consolidated financial statements.

(Figures in tables are in thousand of Azerbaijani manats)

1. Principal activities

OJSC PASHA 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 and its subsidiary (together – "the Bank") accept deposits from the public and extend credit, transfer payments, exchange currencies and provide other banking services to its commercial and private customers.

The Bank has three service points and two branches in Azerbaijan as of 30 June 2014 (31 December 2013: four service points and one representative office).

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

As of 30 June 2014 and 31 December 2013 the following shareholders owned the outstanding shares of the Bank:

<i>Shareholders</i>	<i>30 June 2014</i> <i>(%)</i>	<i>31 December 2013</i> <i>(%)</i>
Pasha Holding Ltd.	60	60
Ador Ltd.	30	30
Mr. Arif Pashayev	10	10
Total	100	100

As at 30 June 2014, the Bank is ultimately owned by Mrs. Leyla Aliyeva and Mrs. Arzu Aliyeva, who exercise joint control over the Bank.

PASHA Bank Georgia JSC, a wholly – owned subsidiary, is located in the Republic of Georgia, operating in the banking sector, with registered and paid up share capital of GEL 35,000 thousand as of 31 December 2013. In March 2014 share capital of subsidiary was increased and amounted to GEL 103,000 as of 30 June 2014. PASHA Bank Georgia JSC operates under a banking licence issued by the National Bank of Georgia (the "NBG") on 17 January 2013.

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

OJSC PASHA Bank and its subsidiary were consolidated in these financial statements.

2. Basis of preparation

General

These interim condensed consolidated financial statements for the six months ended 30 June 2014 have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting*.

The Bank is required to maintain their records and prepare their consolidated financial statements for regulatory purposes in Azerbaijani manat in accordance with International Financial Reporting Standards ("IFRS"). These interim condensed consolidated financial statements are prepared under the historical cost convention except for the measurement at fair value of investment securities available for sale and trading securities.

These interim condensed consolidated financial statements are presented in thousand of Azerbaijani manats ("AZN") unless otherwise indicated. Transactions in currencies other than the AZN are treated as transactions in foreign currencies.

The interim condensed consolidated financial statements do not include all the information and disclosures required in the annual consolidated financial statements, and should be read in conjunction with the Bank's annual financial statements as at 31 December 2013.

(Figures in tables are in thousand of Azerbaijani manats)

3. Changes in accounting policies

The accounting policies adopted in the preparation of the interim condensed consolidated financial statements are consistent with those followed in the preparation of the Bank's annual financial statements for the year ended 31 December 2013, except for the adoption of new Standards and Interpretations as of 1 January 2014, noted below:

Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)

These amendments are effective for annual periods beginning on or after 1 January 2014 provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. This amendment is not relevant to the Bank, since the Bank does not qualify to be an investment entity under IFRS 10.

IAS 32 Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32

These amendments clarify the meaning of "currently has a legally enforceable right to set-off" and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting. These are effective for annual periods beginning on or after 1 January 2014. These amendments had no impact on the Bank's financial position.

IFRIC Interpretation 21 Levies (IFRIC 21)

IFRIC 21 clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. IFRIC 21 is effective for annual periods beginning on or after 1 January 2014. This IFRIC had no material impact on the Bank's financial statements.

IAS 39 Novation of Derivatives and Continuation of Hedge Accounting – Amendments to IAS 39

These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. These amendments are effective for annual periods beginning on or after 1 January 2014. This amendment is not relevant to the Bank, since the Bank has not novated its derivatives during the current period.

Recoverable Amount Disclosures for Non-Financial Assets – Amendments to IAS 36

These amendments remove the unintended consequences of IFRS 13 *Fair Value Measurement* on the disclosures required under IAS 36 *Impairment of Assets*. In addition, these amendments require disclosure of the recoverable amounts for the assets or cash-generating units (CGUs) for which an impairment loss has been recognised or reversed during the period. These amendments had no impact on the Bank's financial position or performance.

4. Cash and cash equivalents

Cash and cash equivalents comprise:

	30 June 2014 (unaudited)	31 December 2013
Cash on hand	45,810	11,768
Current accounts with the CBAR and the NBG	2,723	7,968
Current accounts with other credit institutions	85,209	10,195
Time deposits with credit institutions up to 90 days	17,658	18,125
Cash and cash equivalents	151,400	48,056

Current accounts with other credit institutions consist of interest bearing correspondent account balances with three resident banks in the amount of 3,471 thousand (31 December 2013 – AZN 6,854 thousand) and non-interest bearing correspondent account balances with resident and non-resident banks in the amount of AZN 697 thousand (31 December 2013 – AZN 619 thousand) and AZN 81,041 thousand (31 December 2013 – AZN 2,722 thousand), respectively.

As of 30 June 2014, the Bank placed AZN 17,647 thousand (31 December 2013 – 18,125) in time deposit with one non-resident bank (2013 – with one resident bank and one non-resident bank) maturing through July 2014 and with effective annual interest rate of 0.12% (2013 – maturing through January 2014 and with annual interest rate of 0.10%-11.50%).

(Figures in tables are in thousand of Azerbaijani manats)

5. Trading securities

Trading securities comprise:

	30 June 2014 (unaudited)		31 December 2013	
	Nominal interest rate	Carrying value	Nominal interest rate	Carrying value
Corporate bonds issued by Bakcell LTD	9.50%	14,020	9.50%	14,534
Corporate bonds issued by Unibank Commercial Bank OJSC	11.00%-14.00%	13,930	11.00%-14.00%	15,796
Corporate bonds issued by AccessBank CJSC	9.00%	9,224	9.00%	6,425
Corporate bonds issued by FINCA Azerbaijan limited liability non-banking credit organization	11.50%	4,026	11.50%	6,431
Corporate bonds issued by Bank of Baku OJSC	12.00%	2,549	12.00%	4,533
Corporate bonds issued by "Unileasing" Leasing Company CJSC	10.50%	1,861	10.50%	2,047
Corporate bonds issued by AGBank Commercial Bank OJSC	12.00%	525	12.00%	1,951
Trading securities		46,135		51,717

As of 30 June 2014, the Bank carried market maker service activities and signed related agreements with seven (31 December 2013 – seven) local entities. As of 30 June 2014 the Bank had trading securities under these agreements amounting to AZN 46,135 thousand (31 December 2013 – AZN 51,717 thousand).

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	30 June 2014 (unaudited)	31 December 2013
Time deposits with resident commercial banks	42,875	21,861
Obligatory reserve with the CBAR and the NBG	14,706	10,778
Restricted deposits	595	–
Amounts due from credit institutions	58,176	32,639

As of 30 June 2014, time deposits were placed on inter-bank deposits maturing through June 2015 (31 December 2013 – through 04 June 2014) and with effective annual interest rates between 3% and 11% (31 December 2013 – between 3% and 10%).

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR at 3% per annum and with the NBG at rates of 10% and 15% per annum (31 December 2013 – the CBAR at 3% per annum and the NBG at 10% and 15%) and for the appropriate two-week period (as per the NBG) average of funds attracted from customers by the credit institution in local and foreign currencies, respectively. The Bank's ability to withdraw such deposit is restricted by statutory legislation.

(Figures in tables are in thousand of Azerbaijani manats)

7. Investment securities available-for-sale

Investment securities available-for-sale comprises:

	30 June 2014 (unaudited)		31 December 2013	
	Carrying value	Nominal value	Carrying value	Nominal value
Notes issued by the Azerbaijan Mortgage Fund	208,184	207,561	125,243	123,925
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	28,159	27,933	4,086	4,000
Government Discount Bonds of the Ministry of Finance of Georgia	21,323	22,309	—	—
Notes issued by Baghlan Group FZCO	20,245	19,077	20,605	19,934
Corporate bonds issued by YapiKredi Bank	3,009	3,000	—	—
Certificates of Deposit of National Bank of Georgia	2,689	2,703	5,525	5,564
Government Coupon Bonds of the Ministry of Finance of Georgia	2,013	1,988	—	—
Bank of Georgia Certificates of deposit	1,608	1,572	—	—
Corporate bonds issued by Unibank Commercial Bank OJSC	733	763	—	—
Corporate bonds issued by FINCA Azerbaijan limited liability non-banking credit organization	816	702	—	—
Corporate bonds issued by FinansLizing Open Joint Stock Company (OJSC)	412	400	414	400
Corporate bonds issued by TBC Kredit	305	251	253	250
Investment securities available-for-sale	289,496	288,259	156,126	154,073

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

	30 June 2014 (unaudited)		31 December 2013	
	%	Maturity	%	Maturity
Notes issued by the Azerbaijan Mortgage Fund	3.00%	May 2016 – December 2023	3.00%-3.25%	May 2016 – January 2022
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	1.49%-5.00%	August 2014 – May 2017	4.25%-5.00%	July 2015 – July 2016
Government Discount Bonds of the Ministry of Finance of Georgia	4.34%-7.10%	January 2015 – May 2015	—	—
Notes issued by Baghlan Group FZCO	14.75%	June 2015	14.75%	June 2015
Corporate bonds issued by YapiKredi Bank	9.00%	June 2016	—	—
Certificates of Deposit of National Bank of Georgia	3.98%-4.79%	July 2014 – September 2014	3.80%-4.25%	January-June 2014
Government Coupon Bonds of the Ministry of Finance of Georgia	7.75%-8%	March 2016 – May 2016	—	—
Bank of Georgia Certificates of deposit	5.25%	January 2015	—	—
Corporate bonds issued by Unibank Commercial Bank OJSC	14.00%	May 2018	—	—
Corporate bonds issued by FINCA Azerbaijan limited liability non-banking credit organization	11.50%	July 2016	—	—
Corporate bonds issued by FinansLizing Open Joint Stock Company (OJSC)	14.00%	January 2015	14.00%	January 2015
Corporate bonds issued by TBC Kredit	8.90%	April 2016	7.00%	April 2014

8. Loans to banks

As of 30 June 2014 the Bank had outstanding amount of AZN 5,072 thousand (31 December 2013 – AZN 14,107 thousand) of unsecured loans denominated in Azerbaijani manat, issued to two (31 December 2013 – four) resident commercial banks with contractual maturity through June 2015 (31 December 2013 – June 2014) and annual interest rate of 7.00%-12.00% (31 December 2013 – 8%-12%).

(Figures in tables are in thousand of Azerbaijani manats)

9. Loans to customers

Loans to customers comprise:

	<i>30 June 2014</i> <i>(unaudited)</i>	<i>31 December 2013</i>
Legal entities	357,856	328,939
Individuals	26,666	22,017
Loans to customers (gross)	384,522	350,956
Less – Allowance for impairment (Note 20)	(12,514)	(21,738)
Loans to customers (net)	372,008	329,218

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

	<i>Corporate lending</i> <i>31 December 2013</i>	<i>Individual lending</i> <i>31 December 2013</i>	<i>Total</i> <i>31 December 2013</i>
Individual impairment	(19,538)	(161)	(19,699)
Collective impairment	(1,948)	(91)	(2,039)
	(21,486)	(252)	(21,738)
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	27,200	577	27,777

	<i>Corporate lending</i> <i>30 June 2014</i>	<i>Individual lending</i> <i>30 June 2014</i>	<i>Total</i> <i>30 June 2014</i> <i>(unaudited)</i>
Individual impairment	(9,639)	(54)	(9,693)
Collective impairment	(2,743)	(78)	(2,821)
	(12,382)	(132)	(12,514)
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	95,083	414	95,497

Loans are made in the following industry sectors:

	<i>30 June 2014</i> <i>(unaudited)</i>	<i>31 December 2013</i>
Trade and services	162,053	141,025
Manufacturing	92,746	87,922
Construction	32,672	38,280
Individuals	26,666	22,017
Agriculture and food processing	22,157	21,933
Transport and telecommunication	16,277	12,946
Non banking credit organizations	14,154	13,018
Mining	13,561	12,844
Energy	3,564	171
Leasing	584	744
Other	88	56
Total loans (gross)	384,522	350,956

As of 30 June 2014, the Bank granted loans to 4 customers (31 December 2013 – 7 customers) totalling AZN 109,949 thousand (31 December 2013 – AZN 148,419 thousand), 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.

(Figures in tables are in thousand of Azerbaijani manats)

9. Loans to customers (continued)

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.

10. Investment property

During 2011 the Bank acquired land for the amount of AZN 2,000 thousand as investment property which is held for long-term appreciation in value. As of 30 June 2014, the fair value of this investment property amounted to AZN 2,137 thousand (31 December 2013 – AZN 2,074 thousand).

11. Property and equipment

The movements in property and equipment were as follows:

	Land	Buildings	Furniture and fixtures	Computers and other equipment	Vehicles	Other equipment	Leasehold improvements	Construction in progress	Total
Cost									
31 December 2012	–	4,458	3,465	1,726	992	293	681	–	11,615
Additions	–	–	859	1,078	195	195	905	–	3,232
Disposals	–	–	(6)	(15)	(147)	–	–	–	(168)
30 June 2013 (unaudited)	–	4,458	4,318	2,789	1,040	488	1,586	–	14,679
31 December 2013	–	6,774	5,135	4,081	1,120	471	1,549	–	19,130
Additions	300	–	366	716	103	16	–	2,269	3,770
30 June 2014 (unaudited)	300	6,774	5,501	4,797	1,223	487	1,549	2,269	22,900
Accumulated depreciation									
31 December 2012	–	(120)	(1,082)	(890)	(502)	(43)	(78)	–	(2,715)
Depreciation charge	–	(102)	(381)	(191)	(115)	(34)	(77)	–	(900)
Disposals	–	–	1	4	116	–	–	–	121
30 June 2013 (unaudited)	–	(222)	(1,462)	(1,077)	(501)	(77)	(155)	–	(3,494)
31 December 2013	–	(326)	(1,920)	(1,432)	(637)	(110)	(316)	–	(4,741)
Depreciation charge	–	(169)	(540)	(433)	(122)	(47)	(153)	–	(1,464)
Translation difference	–	–	23	29	2	3	(13)	–	44
30 June 2014 (unaudited)	–	(495)	(2,437)	(1,836)	(757)	(154)	(482)	–	(6,161)
Net book value:									
30 June 2013 (unaudited)	–	4,236	2,856	1,712	539	411	1,431	–	11,185
31 December 2013	–	6,448	3,215	2,649	483	361	1,233	–	14,389
30 June 2014 (unaudited)	300	6,279	3,064	2,961	466	333	1,067	2,269	16,739

(Figures in tables are in thousand of Azerbaijani manats)

12. Intangible assets

The movements in intangible assets were as follows:

	<i>Licenses</i>	<i>Computer software</i>	<i>Total</i>
Cost			
31 December 2012	772	2,165	2,937
Additions (unaudited)	221	482	703
Disposals (unaudited)	(11)	–	(11)
30 June 2013 (unaudited)	982	2,647	3,629
31 December 2013	2,337	2,692	5,029
Additions (unaudited)	272	173	445
30 June 2014 (unaudited)	2,609	2,865	5,474
Accumulated amortization			
31 December 2012	(124)	(535)	(659)
Amortisation charge	(59)	(115)	(174)
Disposals	9	–	9
30 June 2013 (unaudited)	(174)	(650)	(824)
31 December 2013	(257)	(783)	(1,040)
Amortisation charge	(147)	(154)	(301)
Translation difference	(32)	28	(4)
30 June 2014 (unaudited)	(436)	(909)	(1,345)
Net book value:			
30 June 2013 (unaudited)	808	1,997	2,805
31 December 2013	2,080	1,909	3,989
30 June 2014 (unaudited)	2,173	1,956	4,129

13. Other assets and liabilities

Other assets comprise:

	<i>30 June 2014 (unaudited)</i>	<i>31 December 2013</i>
Other financial assets		
Settlements on money transfers	731	673
Accrued interest receivable on guarantees and letters of credit	226	176
	957	849
Other non-financial assets		
Deferred expenses	4,733	5,137
Prepayments for acquisition of property, equipment and intangible assets	3,069	3,029
Prepayments and receivables on other transactions	903	–
Other	12	828
	8,717	8,994
Other assets	9,674	9,843

As of 30 June 2014 deferred expenses of AZN 3,539 thousand (31 December 2013 – AZN 4,078 thousand), related to the long term prepayment for the rent of the service point located in Baku.

As of 30 June 2014 prepayments for the purchase of property, equipment and intangible assets of AZN 3,069 thousand (31 December 2013 – AZN 3,029 thousand) were related to premises for the Bank's new service points.

(Figures in tables are in thousand of Azerbaijani manats)

13. Other assets and liabilities (continued)

Other liabilities comprise:

	30 June 2014 (unaudited)	31 December 2013
Other financial liabilities		
Settlements on money transfer	509	252
Accrued expenses	79	106
Accrued interest payables on letters of credit	26	12
Payables for construction works of branches in regions	8	346
Payables for professional services	5	95
Other	6	—
	633	811
Other non-financial liabilities		
Payables to employees	1,913	2,078
Deferred income	156	137
Taxes, other than income tax	8	78
	2,077	2,293
Other liabilities	2,710	3,104

14. Amounts due to the banks and government funds

Amounts due to banks and government funds comprise:

	30 June 2014 (unaudited)	31 December 2013
Short-term deposits from banks	82,949	69,882
Long-term deposits from banks	40,000	—
Loans from the National Fund for Support of Entrepreneurship	34,920	35,816
Amount due to Azerbaijan Mortgage Fund	1,517	1,572
Correspondent accounts with other banks	63	16
Amounts due to banks and government funds	159,449	107,286

As at 30 June 2014, the Bank received short-term funds from one commercial bank (31 December 2013 – one) and one non-resident commercial bank (31 December 2013 – one) comprising AZN 77,863 thousand (31 December 2013 – AZN 69,882) maturing on May 2015 (31 December 2013 – 19 November 2014) and with annual interest rate of 3%-5% p.a. (31 December 2013 – 3%-5% p.a.)

As of 30 June 2014, the Bank had loans received from the National Fund for Support of Entrepreneurship amounting to AZN 34,920 thousand (31 December 2013 – AZN 35,816 thousand), maturing through May 2023 (31 December 2013 – through May 2023), 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 (31 December 2013 – 6%-7%).

As of 30 June 2014 the Bank had loans refinanced from the Azerbaijan Mortgage Fund amounting to AZN 1,517 thousand (31 December 2013 – AZN 1,572 thousand), maturing through August 2037 (31 December 2013 – through August 2037) and bearing annual interest rate of 4.0%.

15. Amounts due to customers

The amounts due to customers include the following:

	30 June 2014 (unaudited)	31 December 2013
Demand deposits	281,097	183,471
Time deposits	168,091	119,346
Amounts due to customers	449,188	302,817
Held as security against guarantees issued (Note 19)	895	380

(Figures in tables are in thousand of Azerbaijani manats)

15. Amounts due to customers (continued)

An analysis of customer accounts by economic sector follows:

	30 June 2014 (unaudited)	31 December 2013
Individuals	180,251	118,701
Investment holding companies	139,488	99,511
Trade and services	48,425	37,449
Insurance	21,406	15,052
Manufacturing	12,646	3,930
Construction	10,958	9,328
Public organizations	7,769	6,814
Hotel business	7,649	4,243
Transport and communication	7,616	2,501
Mining	6,102	–
Energy	473	102
Agriculture	172	30
Non bank credit organizations	14	802
Other	6,219	4,354
Amounts due to customers	449,188	302,817

As of 30 June 2014 customer deposits included balances with eight largest (31 December 2013 – five) customers amounting to AZN 281,464 thousand (31 December 2013 – AZN 168,872 thousand). These deposits comprise significant concentration of approximately 63% (31 December 2013 – 56%) of the total customer deposits portfolio.

16. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	30 June 2014 (unaudited)	31 December 2013
Commerzbank Aktiengesellschaft	28,516	26,437
Raiffeisen Bank International Aktiengesellschaft	6,766	7,422
Landesbank Baden-Württemberg	3,764	3,254
UBI Banca (Unione Di Banche Italiany) S.C.P.A.	2,603	117
Banco Popolare Group	672	–
Amsterdam Trade Bank N.V.	23	22
Amounts due to credit institutions	42,344	37,252

As of 30 June 2014 amounts due to credit institutions included balances with six (31 December 2013 – five) foreign banks amounting to AZN 42,344 thousand (31 December 2013 – AZN 37,252 thousand), maturing through March 2021 (31 December 2013 – through April 2021) and bearing annual interest rate of 1.40%-37.05% (31 December 2013 – 1.40%-37.05%). These unsecured borrowings are for trade finance of import operations (letters of credit) of the customers of the Bank.

17. Taxation

The corporate income tax expense comprises:

	2014 (6 months) (unaudited)	2013 (6 months) (unaudited)
Current tax charge	(2,232)	(1,812)
Deferred tax charge	619	(549)
Less: deferred tax recognized directly in other comprehensive income	174	(148)
Income tax expense	(1,439)	(2,509)

(Figures in tables are in thousand of Azerbaijani manats)

18. Equity

On 4 February 2013, the shareholders of the Bank declared dividends totalling AZN 20,515 thousand. The dividends were paid to the shareholders of the Bank on 9 April 2013.

On 18 February 2013, the shareholders of the Bank decided to increase share capital of the Bank by additional cash contribution amounting to AZN 21,000 thousand. Increase of share capital was finalized on 14 June 2013. The increase was carried out by converting 10,000 shares with a par value of AZN 15,700.00 per share into an equal number of shares with a par value of AZN 17,800.00 per share.

On 25 June 2013, the shareholders of the Bank decided to increase share capital of the Bank by additional cash contribution amounting to AZN 50,000 thousand. Increase of share capital has been finalized on 30 July 2013. The increase was carried out by converting 10,000 shares with a par value of AZN 17,800.00 per share into an equal number of shares with a par value of AZN 22,800.00 per share.

On 24 December 2013, the Shareholders of the Bank declared its intention to pay dividends in the amount of 100% of the statutory net profit of the Bank earned based on the results of 2013. Based on the decision the Bank accrued dividends of AZN 14,992 thousand as at 31 December 2013 and paid in the first half of 2014.

On 14 February 2014, the shareholders of the Bank decided to increase share capital of the Bank by additional cash contribution amounting to AZN 105,000 thousand. Cash contribution to the share capital was made by existing shareholders on 22 April 2014. The increase was carried out by converting 10,000 shares with a par value of AZN 22,800.00 per share into an equal number of shares with a par value of AZN 33,300.00 per share.

As at 30 June 2014, the Bank authorized, issued and fully paid capital amounted to AZN 333,000 thousand (2013 – AZN 228,000 thousand) comprising of 10,000 ordinary shares with a par value of AZN 33,300.00 per share (2013 – AZN 22,800.00). Each ordinary share entitles one vote to the shareholder.

19. 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 Azerbaijani 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 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.

(Figures in tables are in thousand of Azerbaijani manats)

19. Commitments and contingencies (continued)

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 30 June 2013 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.

Compliance with CBAR ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 30 June 2014, the Bank was in compliance with these ratios except for ratio of maximum credit exposure of a bank per a single borrower or a group of connected borrowers that should not exceed 7 percent of the bank's total capital when the market value of the security of credit exposures is less than 100 percent of such credit exposures, or the market value of real estate collateral of loans is below 150% of the loan value. As at 30 June 2014, the Bank's ratio was 7.59% for one borrower (31 December 2013 – 17.25% for one borrower).

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.

Financial commitments and contingencies comprise:

	30 June 2014 (unaudited)	31 December 2013
Credit-related commitments		
Guarantees issued	45,590	44,160
Unused credit lines	33,114	26,635
Letters of credit	19,117	11,093
	<u>97,821</u>	<u>81,888</u>
Operating lease commitments		
Not later than 1 year	1,973	726
Later than 1 year but not later than 5 years	5,948	1,471
Later than 5 years	5,261	150
	<u>13,182</u>	<u>2,347</u>
Less – Provisions (Note 20)	(644)	(150)
Commitments and contingencies (before deducting collateral)	<u>110,359</u>	<u>84,085</u>
Less – Cash held as security against guarantees issued (Note 15)	(895)	(380)
Commitments and contingencies	<u>109,464</u>	<u>83,705</u>

(Figures in tables are in thousand of Azerbaijani manats)

20. 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 provisions for guarantees and letters of credit were as follows:

<i>6 month ended 30 June 2014 (unaudited)</i>				
	<i>Corporate lending</i>	<i>Individual lending</i>	<i>Total loans to customers</i>	<i>Guarantees and other commitments</i>
At 1 January 2014	(21,486)	(252)	(21,738)	(150)
Charge for the period	(9,399)	(40)	(9,439)	(494)
Amounts written off	18,531	160	18,691	—
Recovery	(31)	—	(31)	—
Exchange rate difference	3	—	3	—
At 30 June 2014 (unaudited)	(12,382)	(132)	(12,514)	(644)
	<i>Corporate lending</i>	<i>Individual lending</i>	<i>Total loans to customers</i>	<i>Guarantees and other commitments</i>
At 1 January 2013	(8,066)	(630)	(8,696)	(967)
Charge for the period	(7,569)	(5)	(7,574)	(185)
At 30 June 2013 (unaudited)	(15,635)	(635)	(16,270)	(1,152)

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.

21. Net fee and commission income

Net fee and commission income comprise:

	<i>2014 (6 months) (unaudited)</i>	<i>2013 (6 months) (unaudited)</i>
Guarantees and letters of credit	1,082	1,168
Servicing plastic card operations	615	503
Settlements operations	595	575
Cash operations	368	356
Underwriting and market maker operations	205	405
Other	19	13
Fee and commission income	2,884	3,020
Servicing plastic card operations	(661)	(732)
Guarantees and letters of credit	(361)	(323)
Settlements operations	(233)	(266)
Securities operations	(44)	(51)
Cash operations	(15)	—
Other	(75)	(86)
Fee and commission expense	(1,389)	(1,458)
Net fee and commission income	1,495	1,562

(Figures in tables are in thousand of Azerbaijani manats)

22. Personnel, general and administrative expenses

Personnel expenses comprise:

	<i>2014 (6 months)</i> <i>(unaudited)</i>	<i>2013 (6 months)</i> <i>(unaudited)</i>
Salaries and bonuses	(3,982)	(3,991)
Social security costs	(816)	(823)
Other employee related expenses	(991)	(675)
Total personnel expenses	(5,789)	(5,489)

General and administrative expenses comprise:

	<i>2014 (6 months)</i> <i>(unaudited)</i>	<i>2013 (6 months)</i> <i>(unaudited)</i>
Operating leases	(1,934)	(1,036)
Professional services	(1,283)	(793)
Charity and sponsorship	(683)	(284)
Advertising costs	(485)	(360)
Software cost	(387)	(216)
Transportation and business trip expenses	(212)	(151)
Utilities	(167)	(173)
Insurance	(137)	(113)
Communications	(130)	(61)
Repair and maintenance	(123)	(36)
Security expenses	(106)	(77)
Stationery	(50)	(44)
Taxes, other than income tax	—	(30)
Printing expenses	(28)	(11)
Membership fees	(27)	(15)
Other expenses	(237)	(229)
Total general and administrative expenses	(5,989)	(3,629)

23. 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:

	<i>Date of valuation</i>	<i>Fair value measurement using (unaudited)</i>			<i>Total</i>
		<i>Quoted prices in active markets (Level 1)</i>	<i>Significant observable inputs (Level 2)</i>	<i>Significant unobservable inputs (Level 3)</i>	
Assets measured at fair value					
Trading securities	30 June 2014	46,135	—	—	46,135
Investment securities available-for-sale	30 June 2014	213,047	28,571	47,878	289,496
Investment property	30 June 2014	—	—	2,137	2,137
Assets for which fair values are disclosed					
Cash and cash equivalents	30 June 2014	151,349	—	—	151,349
Amounts due from credit institutions	30 June 2014	—	—	58,227	58,227
Loans to banks	30 June 2014	—	—	5,072	5,072
Loans to customers	30 June 2014	—	—	372,008	372,008

(Figures in tables are in thousand of Azerbaijani manats)

23. Fair value of financial instruments (continued)

		Fair value measurement using (unaudited)			
	Date of valuation	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Liabilities for which fair values are disclosed					
Amounts due to the CBAR, banks and government funds	30 June 2014	—	—	159,448	159,448
Amounts due to credit institutions	30 June 2014	—	—	42,344	42,344
Amounts due to customers	30 June 2014	—	—	449,188	449,188

Fair value hierarchy for financial instruments measured at fair value as at 31 December 2013

		Fair value measurement using			
	Date of valuation	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets measured at fair value					
Trading securities	31 Dec 2013	51,717	—	—	51,717
Investment securities available-for-sale	31 Dec 2013	146,101	4,500	5,525	156,126
Investment property	31 Dec 2013	—	—	2,074	2,074
Assets for which fair values are disclosed					
Cash and cash equivalents	31 Dec 2013	48,056	—	—	48,056
Amounts due from credit institutions	31 Dec 2013	—	—	32,639	32,639
Loans to banks	31 Dec 2013	—	—	14,107	14,107
Loans to customers	31 Dec 2013	—	—	329,218	329,218

		Fair value measurement using			
	Date of valuation	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Liabilities for which fair values are disclosed					
Amounts due to the CBAR, banks and government funds	31 Dec 2013	—	—	107,286	107,286
Amounts due to credit institutions	31 Dec 2013	—	—	37,252	37,252
Amounts due to customers	31 Dec 2013	—	—	302,817	302,817

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.

Movements in level 3 assets and liabilities at fair value

The following table shows a reconciliation of the opening and closing amount of Level 3 assets which are recorded at fair value:

<i>Assets</i>	<i>At 1 January 2014</i>	<i>Purchases</i>	<i>Interest income</i>	<i>Settlements</i>	<i>Recovery</i>	<i>Transfers from Level 1</i>	<i>At 30 June 2014 (unaudited)</i>
Investment securities available-for-sale	5,525	29,157	503	(7,552)	4,324	15,921	47,878
	5,525	29,157	503	(7,552)	4,324	15,921	47,878

(Figures in tables are in thousand of Azerbaijani manats)

23. Fair value of financial instruments (continued)

The following table shows the quantitative information about significant unobservable inputs used in the fair value measurement categorized within level 3 of the fair value hierarchy:

30 June 2014 (unaudited)	Carrying amount	Valuation techniques	Unobservable input	Range of discount rate	Sensitivity of the fair value to the input
Investment securities available-for-sale					
Treasury bills of the Ministry of Finance of Georgia	21,323	Discounted cash flow	Discount rate	6.40% – 6.58%	10% increase (decrease) in discount rate would result in decrease (increase) in fair value by AZN 80 thousand (AZN 104 thousand)
Notes issued by Baghlan Group FZCO	20,245	Discounted cash flow	Discount rate	14.75%	10% increase (decrease) in discount rate would result in decrease (increase) in fair value by AZN 98 thousand (AZN 98 thousand)
Certificates of deposit of the NBG	2,689	Discounted cash flow	Discount rate	4.29% – 4.32%	10% increase (decrease) in discount rate would result in decrease (increase) in fair value by AZN 1 thousand (AZN 2 thousand)
Government coupon bonds of the Ministry of Finance of Georgia	2,013	Discounted cash flow	Discount rate	7.79% – 8.01%	10% increase (decrease) in discount rate would result in decrease (increase) in fair value by AZN 14 thousand (AZN 36 thousand)
Certificates of deposit of the Bank of Georgia	1,608	Discounted cash flow	Discount rate	5.25%	10% increase (decrease) in discount rate would result in decrease (increase) in fair value by AZN 5 thousand (AZN 4 thousand)

In order to determine reasonably possible alternative assumptions the Bank adjusted the above key unobservable model inputs by increasing and decreasing the discount rate by 10 per cent.

Transfers between level 1 and 3

Notes issued by Baghlan Group FZCO were transferred from level 1 to level 3 as they ceased to be actively traded during the period and no market price quotations available for these bonds. The fair values reported in these financial statements were obtained using valuation techniques by applying unobservable market inputs. Management believes that the fair value recognised as of 30 June 2014 for these bonds will be recoverable. Respective steps are currently taken by the Bank to ensure the notes recoverability. There have been no transfers from level 1 to level 3 in 2013.

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 statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

(Figures in tables are in thousand of Azerbaijani manats)

23. Fair value of financial instruments (continued)

	Carrying value 30 June 2014 (unaudited)	Fair value 30 June 2014 (unaudited)	Unrecognized gain/(loss) 30 June 2014 (unaudited)	Carrying value 31 December 2013	Fair value 31 December 2013	Unrecognized gain/(loss) 31 December 2013
Financial assets						
Cash and cash equivalents	151,400	151,400	—	48,056	48,056	—
Amounts due from credit institutions	58,176	58,176	—	32,639	32,639	—
Loans to banks	5,072	5,072	—	14,107	14,107	—
Loans to customers	372,008	372,008	—	329,218	329,218	—
Financial liabilities						
Amounts due to banks and government funds	159,449	159,449	—	107,286	107,286	—
Amounts due to customers	449,188	449,188	—	302,817	302,817	—
Amounts due to credit institutions	42,344	42,344	—	37,252	37,252	—
Total unrecognised change in unrealised fair value			—			—

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.

24. 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:

	30 June 2014 (unaudited)					31 December 2013				
	Parent	Entities under common control	Key management personnel	Other	Total	Parent	Entities under common control	Key management personnel	Other	Total
Loans, gross	—	16,519	1,288	—	17,807	25	13,467	1,003	—	14,495
Less: allowance for impairment	—	(71)	(2)	—	(73)	—	(35)	—	—	(35)
Loans, net	—	16,448	1,286	—	17,734	25	13,432	1,003	—	14,460
Deposits	25,053	16,157	37	77,538	118,785	988	12,044	272	68,196	81,500
Current accounts	9,947	102,455	76	71,019	183,497	15,178	97,279	477	26,011	138,945
Unused credit lines	93	3,080	121	24	3,318	73	969	62	11	1,115

(Figures in tables are in thousand of Azerbaijani manats)

24. Related party disclosures (continued)

The income and expense arising from related party transactions are as follows:

	<i>For the six months ended</i>									
	<i>30 June 2014 (unaudited)</i>					<i>30 June 2013 (unaudited)</i>				
	<i>Parent</i>	<i>Entities under common control</i>	<i>Key management personnel</i>	<i>Other related parties</i>	<i>Total</i>	<i>Parent</i>	<i>Entities under common control</i>	<i>Key management personnel</i>	<i>Other related parties</i>	<i>Total</i>
Interest income on loans	–	732	62	–	794	1	477	31	–	509
Interest expense on deposits	(369)	(1,049)	(14)	(1,504)	(2,936)	(1,256)	(540)	(17)	(1,703)	(3,516)
Fee and commission income	8	213	6	1	228	7	322	–	2	331
General and administrative expenses	–	(967)	–	(182)	(1,149)	–	(1,167)	–	(35)	(1,202)
						<i>2014 (6 months) (unaudited)</i>		<i>2013 (6 months) (unaudited)</i>		
Salaries and other benefits						(810)		(1,372)		
Social security costs						(135)		(241)		
Total key management compensation						(945)		(1,613)		

25. 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 6 months of 2014, 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.

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 30 June 2014 and 31 December 2013 the Bank's capital adequacy ratio on this basis was as follows:

	<i>30 June 2014 (unaudited)</i>	<i>31 December 2013</i>
Tier 1 capital	329,334	228,000
Tier 2 capital	11,378	7,336
Less: Deductions from capital	(47,481)	(20,140)
Total regulatory capital	293,231	215,196
Risk-weighted assets	658,625	591,258
Capital adequacy ratio	45%	36%

(Figures in tables are in thousand of Azerbaijani manats)

25. Capital adequacy (continued)

NBG capital adequacy ratio

The NBG requires banks to maintain a minimum total capital adequacy ratio of 12% of risk-weighted assets for regulatory capital. As of 30 June 2014, the Bank's subsidiary's capital adequacy ratio was 102% (as of 31 December 2013 – 130%).