PASHA Bank

Annual report 2011

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Introduction

Foreword by Chairman of the Supervisory Board and Chairman of the Executive Board

Dear shareholders, valued customers and partners,

We are extremely pleased to state that in general the year of 2011 was a quite successful for us.

Last year the Bank has maintained its position as one of the largest market players – the total capital was more than 149 million manats and the assets exceeded half a billion manats. We are on the second place as per value of our paid-in capital and among the 5 leading banks of the country in respect of asset value.

You will receive more detailed information on figures in our report, while we would like to draw your attention to the highlights of our achievements:

In 2011 we completed our first three-year development strategy. Three years ago we set targets that were quite ambitious for the bank which had just been established:

- to perform business activities at the highest transparency level;
- to provide the customers with services of the highest quality;
- to become a bank with a strong financial position;
- to create the corporate culture meeting the highest international standards;
- to establish an innovative entity with the high technologies;
- to be among the leaders of corporate customer sector;
- to establish the state of the art Private Banking Department;
- to create the strong, high-quality, prestigious bank brand.

Now, on the basis of the last year results, we can happily state that most of the set targets were successfully achieved.

The Bank, remaining committed to the transparency principles, fully complied with the existing legislation and internal regulations and with the corporate governance standards accepted by the international business community. The Bank is open to the public and has closely cooperated with both local and foreign media; disclosed to the public monthly financial reports and other information.

We have worked towards the development of the Private Banking and have become the first Azerbaijani bank to participate in the special "Professional Private Banking courses" in Geneva. Our personnel completed the training courses organized by the Banking school at the Geneva Banking Association mastering subtleties or, we would say, the essence of the of Swiss private banking system.

Participation in the international summits like SIBOS, organisation of large-scale "road-shows" in Germany, Great Britain and Switzerland enabled us to establish relationships with leading international financial institutions in a short time period and open "new horizons" for future development. This afforded us an opportunity to provide more extensive services to our customers and to lay a foundation for perfection of the quality and for increase of the quantity of the customer base.

During implementation of our first Strategy, we focused on ensuring high service quality, minimisation of the time spent by the customers on the banking transactions and ensuring the complete confidentiality of the obtained information. Therefore, we have arranged systematic trainings and workshops for our personnel in and outside Azerbaijan, which enabled active familiarisation with and analysis of the customer requirements. We have established an efficient mechanism for receipt and review of the customer complaints and suggestions; have provided conditions for prompt decisions increasing the liability requirements for the custom-tailored services.

We strive to implement the most advanced technologies based on the western banking model. By ensuring the compliance with anti-money laundering principles, we were the first bank in Azerbaijan to implement the SafeWatch filtering program, which enabled us to become one of the leading banks not only in the Caucasus, but also in the Commonwealth of Independent States as well.

We have strengthened the regulation of the business processes in the Bank and developed the quality control system monitoring the performance of the internal procedures by Compliance Department.

PASHA Bank pays a great attention to the risk management. One of the slogans of the Bank is "each employee of PASHA Bank is a risk manager". The main objective of the PASHA Bank risk management is to achieve the optimal correlation of risk and profit.

In 2011 risk management was really important, because the post-financial crisis period made it necessary to assess internal and external risk factors both at existing bank portfolio and future contracts level. Owing to our considered actions we managed to avoid financial losses and to gain maximum possible profit in the given economic situation.

At present a single risk management method considering the management of the financial and operational risks is being implemented.

The year of 2011 was also remembered with several successful transactions of the Bank in the securities market. Starting from the beginning of the year PASHA Bank offered to the legal entities existing in the market the underwriting services rendered by the professional participants of the securities market and those services were actively supported by the securities market.

In 2011 the Bank completed its preparations for opening its first foreign representative offices – the office in Georgia, the country that is considered as more perspective one on international scale. We have planned the official opening of PASHA Bank Georgia in the second half of 2012.

The Bank pays great attention to the strengthening of direct participation in the social life of the country considering the high socioeconomic growth rate of Azerbaijan. As an organisation with social responsibilities in the market, the Bank during these years was directly involved in numerous projects on development of the society. They include cultural projects, for example financing of the children's international mugham festival, interesting scholarship programs for support and stimulation of the youth, projects conducted together with the Junior Achievement association and other similar activities.

Naturally, the absolute values of the banking activity, i.e. liabilities, assets, profitability, capital, as well as the organisational development are always important and you will see that in the report for yourselves, however, the main internal parameters for PASHA Bank are high-quality performance, "health indicator of the entity", and correct utilisation of the special resources and improvement of the employee qualification. In 2011 we achieved positive results in this direction as well.

PASHA Bank pays special attention to the personnel management and development: human resources are the cornerstones and one of the leading assets for us. We could state with pleasure that during these years we were able to gather a highly professional team, to cultivate the corporate awareness, the perception of individual responsibility in general development.

At the end of 2011 we were first in the country in terms of operational income per employee, considering that we had approximately 150 employees. PASHA Bank also has the least expense indicators per the general income of the bank, that is, we spend about 30% of each earned manat, which indicates accurate system functioning. All these facts are interesting for our shareholders from the point of view of investment attractiveness.

As for our strategy planned for 2012-2014, we continue focusing on issues we consider important – work with corporate clients, treasury operations and private banking. We also plan to closely cooperate with the small and medium enterprises, to continue active participation in securities market, to open new branch office within and outside the country. These projects will enable us to strengthen our status as one of the leading market participants and to enhance the concept of "PASHA Bank" brand as the leading corporate bank of Azerbaijan.

In conclusion, we would like to note once again that we are celebrating the 5th anniversary of our Bank this year (2012). During this period our successful activity in Azerbaijani market was warranted by the conformance to the principle "INTEGRITY, QUALITY AND PROFITABILITY". We are intending to strengthen our position in the local banking market, to earn the respect of the consumers of bank services, to remain loyal to these principles and to actively cooperate with our customers and promptly respond to their requirements in coming years too.

Yours sincerely,

Mir Jamal Pashayev
Chairman of the
Supervisory Board

Farid Akhundov
Chairman of the
Executive Board

PASHA Bank in Brief

- Registered with the Ministry of Justice as an open joint stock company on 18th June 2007 and focused on servicing corporate and private customers.
- Is operating under the license of Central Bank dated 28th November 2007.
- Owned by PASHA Holding – a leading Azerbaijani holding company, which also has stakes in the firms in construction, real estate, insurance, travel and leisure and other sectors.
- Offers all common types of corporate banking services and is widely accepted as one of the most perspective, strong and transparent financial organizations of the country.
- Audited semi-annualy by *Ernst & Young* audit firm, also cooperates with *Deloitte, PriceWaterhouseCoopers* and *Baker & McKenzie*.
- Open for all types of companies, including small and medium size enterprises that require a legal due diligence into the Bank's adherence to the transparency standards.

Vision

- To be a leading Azerbaijani bank committed to the highest standards of ethics, indisputable business reputation, quality of services and financial strength.

Mission

- To contribute to the growth of our customers by providing high-quality products and services tailored to our customers' needs;
- To employ, train and nurture the competent and devoted personnel;
- To remain committed to the welfare and cultural development of society;
- To maintain strong financial position;
- To remain committed to transparent and prudent conduct of business.

Strategic Goals

- Be a leading corporate bank of the country;
- Establish a fully-functional Private Banking capacity;
- Enhance the system of corporate governance;
- Build internal culture aligned with business philosophy of the organization;
- Strengthen external and internal recognition of the Bank's brand;
- Enhance information technology systems within the organization;
- Optimize human resources management system to support the corporate strategy;
- Maintain strong financial position

PASHA Holding

PASHA Bank	PASHA Insurance	PASHA Travel	PASHA Construction	PASHA Life	KAPİTAL BANK
60%	100%	60%	60%	100%	99.75%

Financial Highlights

in thousands of Azerbaijani manats

	Year end 2009	6 months ended 30 June 2012	Year end 2010	6 months ended 30 June 2011	Year end 2011
Total assets	306,433	340,965	512,304	496,188	573,880
Loans to customers	119,520	178,588	187,868	203,507	234,004
Customers' time deposits	72,610	71,134	147,080	141,725	165,874
Customers' current accounts	93,780	110,264	191,519	169,863	205,625
Shareholders' equity	126,570	135,110	136,815	141,887	149,183
Interest income	24,384	16,050	33,842	17,399	37,758
Fee & commission income	1,445	967	2,065	1,291	3,397
Net gains on dealings with currency	1,781	2,013	3,750	1,395	3,196
Operating profit	22,677	15,121	30,343	12,360	31,037
Net profit	16,059	8,540	13,871	5,072	13,359
Income per employee	176	220	196	111	132
Total operating expenses	5,731	4,099	4,787	4,564	11,523
Cost per employee	62	82	87	65	78
ROA (average for the year)	7.05%	6.46%	4.10%	3.14%	3.39%
ROE (average for the year)	16.95%	19.10%	18.20%	12.63%	15.80%
Loans to deposits	73.37%	100.93%	57.91%	69.24%	66.06%
Cost to income	25.27%	27.11%	30.79%	36.93%	37.12%
Non % income / total income	14.11%	18.15%	17.38%	12.22%	19.58%

Financial Briefing

Despite the difficult financial environment and strong competition in the market, PASHA Bank has successfully completed its first strategic period aimed at strengthening the bank as a leading provider of corporate banking services. Among our achievements we can highlight our geographical expansion: In September 2011 we have opened a representative office in Tbilisi with an aim to start providing full range of banking services in Georgia in 2012.

New card products have been designed for specific needs of the market and have successfully been introduced . PASHA Bank has also invigorated its activities in the securities market having successfully closed several deals as underwriter and market- maker. Throughout a year we have made our best to remain faithful to our mandate which ensures a tailor-made approach to the needs of our clients.

Bank has kept its position as one of the largest commercial banks in terms of total equity which reached the level of AZN 149,182,657 (USD 189,679,157).

As a result of strategic decision to diversify its assets portfolio, Bank has efficiently managed to keep a good balance of services offered to its clients.

At the end of 2011 PASHA Bank assets totalled to AZN 573,879,801 (USD 729,662,811), which demonstrated an increase of 12% compared to 2010 (AZN 512,304,248 / USD 651,372,216).

The breakdown of Bank's assets for 2011 is as follows:

- securities portfolio – 46%;
- loans to customers – 41%;
- cash and cash equivalents – 6%;
- due from banks (receivables from banks) – 4% and the rest attributed to other non-current and current assets.

PASHA Bank has efficiently balanced its positions in rather complex economic situation of global financial crisis. The loan market was quite weak and source of financing limited. Difficulties were observed in credit risk assessment. This has increased demand for loans in corporate sector, especially the companies that are involved in international business. However, throughout the crisis PASHA Bank has benefited from its strong capital position and established itself in the market as a robust and reliable partner for companies with transparent and sustainable management. Main objective of the Bank was to support its existing SME client base in the time of financial turmoil. The Bank has started servicing SME sector from 2011 year, building capacity and strengthening its positions in this sector.

We maintained our liquidity at the desirable level this year, with 67% increase in our securities portfolio (AZN 260,975,703 (USD 331,819,076)). In 2010 the relevant figure was AZN 156,578,565 / USD 199,082,727. We have generated a strong loan growth increasing our portfolio by 26% to AZN 246,769,000 (USD 313,755,880). Relevant figure for the year 2010 was AZN 196,081,000 (USD 249,308,328),

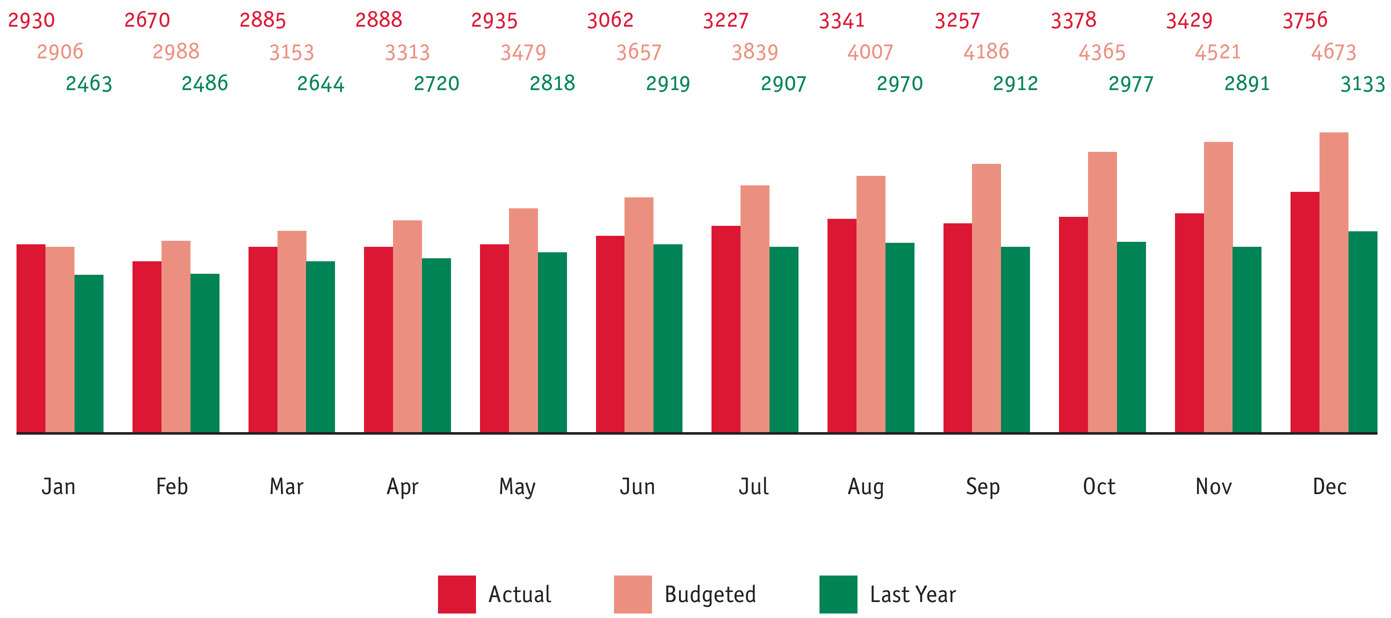
Effective provision rate on the portfolio was 5.2% (2010 – 4.2%). Non-performing loans (NPL) increased from 0.6% of gross portfolio for the period ended 2010 to 10.75% for the year ended 2011 based on the reassessment of the evaluation techniques applied by the Bank. This ratio is based on Bank's internal methodology of setting up provisions for NPLs and is kept under close scrutiny of the Bank's Board and Credit Committee. Larger portion of NPLs (65%) is related to two corporate customers who have improved their books for the desired level by the end of 2011. However, the Bank's management made the decision not to change the status of those borrowers from non-performing to performing loans taking into consideration the strain in the industry overall and challenging market conditions.

By staying consistent and serving customers in tumultuous times, we are now benefiting from the relationships that we've developed over the last few years. As a result we have generated strong growth in customer base with balance of AZN 371,499,366 (USD 472,345,030). Relevant figure for the previous year was AZN 338,598,787 (USD 430,513,397). The customers' balances were mainly concentrated in demand and term accounts in the proportion of 55% and 45%, respectively and this proportion was approximately the same for the prior year.

The Bank's net profit for 12 months ended in 2011 comprised AZN 13,359,130 (USD 16,985,543), which is almost the same as in comparison with the relevant period of 2010 (AZN 13,870,970 /USD 17,636,325). The reason for a slight decrease was reduction of the average interest rates on loans disbursed to the customers, excess deposit portfolio and interest expenses as well as deferred income tax charges. Our pre-tax profit comprised AZN 15,150,307 (USD 19,262,945) meaning 4% increase in comparison with the previous year (AZN 14,552,091 /USD 18,502,341).

Interest income of the Bank has increased by 12% and reached AZN 37,758,020 (USD 48,007,654), whereas non-interest income has increased by 16% and comprised AZN 6,076,000 (USD 7,725,366). As a result of successful negotiations with international financial institutions, PASHA Bank was able to provide its corporate clients by a wider range of trade finance services and financial instruments. Documentary operations balances increased by 18% to AZN 43,689,159 (USD 55,548,835) from AZN 37,114,180 (USD 47,189,040) in 2010. The current strategic objective for PASHA Bank is to grow its trade finance portfolio up to AZN 105,000,000 (USD 133,502,861) in 2012.

Our ROA remained strong at 3.4%, while our ROE came as 15.8% (calculated on the basis of profit before tax and provision). These results generated strong internal capital growth, producing an estimated Tier 1 capital adequacy ratio under current Basel capital proposals of 51%. We remain focused on meeting the required capital levels once Basel II and Basel III are finalized while returning capital to our shareholders through dividends. During 2011 the Bank has paid dividends to the shareholders from the 2010 net profit in the amount of AZN 981,358 (USD 1,247,753), which is 7.3% of total net profit of the Bank.



Total Interest Income for 12 months ended 31 December 2011 was AZN 37 million 758 thousands of Azerbaijani manats

Operations

Back office

Strategic objectives of our Bank, without doubt, influence the activity of back office as well. Moreover, the back office is given a task to achieve a higher level of service provision. Therefore, the back office must ensure uninterrupted and reliable performance of system operations. So, the back office must consider and participate in realization of projects for improvement of hardware and software. As a result, last year the Bank successfully completed the first large-scale project on implementation of modern foreign automation system. Implementation of the automated bank system (BankSyst) developed by Tieto enabled us to automate most operations, expand the function range and strengthen the operation control system. All main modules of the system (Customer module, General Ledger, Payment, Reporting and some other modules) were released in eighteen months. In addition to the BankSyst, during the same time period we implemented another modern banking software, the special card module – Card Suite – developed by one of the leaders of card systems - Tieto Latvia and created interface between two systems.

In addition to the above, we continued mastering and implementing the specialised card module – Card Suite system. We have completed SMS, PIN-Change, P2P ("card to card") functions and started expansion of the module. This enabled us to utilize human resources more efficiently, to reduce the usage of printed media and, at last, to achieve our most important objective, i.e., facilitated service provision to our customers and expansion of the offered product range.

In order to realize these opportunities and to increase the range of offered services PASHA Bank took another step and introduced a number of new card products for its customers.

At the same time, our Bank expands relationships with international banking systems. Our Bank has taken measures to establish close working relations with MasterCard, Visa and SWIFT organisations. We extend relations with these companies, review the products offered by them not only from the point of view of our business, but in the retrospect of tendencies generally observed in banking sector of our country and specifics of our market and identify the most interesting ones of those offers. Thus, we received Principal Membership in MasterCard and VISA card payment systems during this period. The membership gave our Bank a number of advantages, including the optimisation of payments made by MasterCard and VISA cards and, in consequence , improvement of service quality.

In connection with the policy of development of clearing settlements in Azerbaijan, our Bank achieved certain successes in expansion of the POS-Terminal network. For example, last year we installed POS-terminals in new places, thus increasing the number of this equipment to 100 and continue working in this direction. Moreover, our Bank already offers e-commerce service to the corporate customers willing to perform transactions through Internet. Conceptually, this service enables "Virtual POS-Terminal" payments, i.e., payments without physical equipment.

In order to facilitate the acquisition of information about the services we have established Service Centre in our Bank, which at the moment can be used only by the card holders. At the present stage this service works 15 hours a day, but soon we will offer 24 hour service. It must be noted that although the establishment of the Service Centre started only with card operation services, we are intended to use it for provision of 24 hour services and consultations on all bank services without a need to visit the service offices. So, the card operations service is only the first phase of this plan. Subsequently, the Call Centre will cover all services offered by the Bank.

Without doubt, all listed opportunities put big demands from modernity and innovation point of view. This direction is one of the issues our business is focused on. We try to ensure the conformance of IT provision in all newly opened service centres of the Bank to the highest international standards. At the same time, utilisation of new trends and tendencies of advanced IT-based technologies is an important part of our future plans.

Treasury and deposit related operations

Following the 2011 results, the funds managed by the Treasury Department constituted 56% of the Bank assets and were equal to 322 million manats. This figure included 40 million manats in cash and correspondent accounts, 261 million manats securities portfolio and 26 million manats inter-bank credit/deposit portfolio.

As for profitability, the interest income earned by the Department constituted 25% of the total income of the Bank and equaled to 9.3 million manats. The earnings of the Department from securities and currency trade, i.e., from "dealings" were about 3.1 million manats, which constituted about 59% of non-interest income of the Bank. The Bank extended its transactions to FX derivative products and, at the same time, started the Eurobond trade. The volume of securities portfolio of the Bank has increased by 47%.

The year of 2011 was also remembered with several successful transactions of the Bank in the securities market. Starting from the beginning of that year the Department offered to the legal entities existing in the market the underwriting services rendered by the professional participants of the securities market and these services were actively supported by the securities market.

In 2011 PASHA Bank issued loans for 4 issuing companies in total amount of 70.4 million manats, which was successfully placed among the participants of the securities markets. The issuing companies were Finance Leasing (0.4 million manats), UniLeasing (10 million manats), UniBank (20 million manats) and Bakcell (40 million manats). Flotation of UniBank's loan (20 million manats) was the first practice of placement of the loans of one local commercial bank in the market by another local commercial bank. Moreover, for the first time in the securities market a commercial bank started rendering market-making services through professional market participants.

The official ISE web-site and Bloomberg Terminal displays daily prices of UniLeasing, UniBank and Bakcell loans defined by the Department. PASHA Bank intends to expand the scope of underwriting and market-making services in the future.

Private Banking

Private Banking being the one of the business directions of the Bank started providing services to its first customers in 2011. This department with ambitious objectives was first in Azerbaijan to send five employees to participate in Private Banking training program in Geneva organised by world-known ISFB banking school and to learn and master subtleties of Private Banking system.

2011 was also quite productive from the point of view of establishment of relationships with prospective partners. As a result of held meetings, conducted negotiations and carried on correspondence we established relations with several entities rendering financial and non-financial services.

Department employees have developed several new bank deposit products and now working together with the Bank System development department in order to include the parameters of these products into the automated system of bank operations.

The Department organised a number of conferences and workshops for existing and potential customers; one of them – "Private Banking and Wealth Management" workshop organised together with a member of Big Four - Deloitte audit company, was a big success and well received by the very specific audience.

In 2011 the Private Banking with support of the Public Relations and Marketing Department of the Bank and together with the Embassy of Switzerland to Azerbaijan conducted a number of events for representatives of Switzerland Chamber of Commerce visiting Azerbaijan and Bank customers that contributed to the establishment of commercial and business relations between the two parties.

Corporate Banking

Three years ago PASHA Bank set forward rather ambitious targets:

- to become the leading corporate bank of the country;
- to provide opportunities for fully functional private bank services;
- to strengthen corporate management system;

- to establish internal culture conforming to the business philosophy of the entity;
- to increase the recognition of the bank's brand in the country and abroad;
- to strengthen information technologies system within the organisation;
- to optimise human resources/staff management system in order to support the internal strategy of the organisation;
- to maintain the durability of the financial situation.

According to the results of the last year, we may state that the department achieved most of the determined objectives.

Considering continuously increasing customer base of PASHA Bank, following the principles of the abovementioned Strategy, based on PASHA Bank Corporate Strategy for 2012-2014 and by ensuring high-quality services and products tailored to the needs of our customers we have set the objective to contribute to the development of our customers.

Arrangements have been made to ensure provision of the services of exceptional quality, range of products adjusted to the customer requirements, capacity to provide expert opinions and financial consultations, as well as the enhancement of the image of the Bank as transparent, open and accessible financial institution.

Also, PASHA Bank Customer Service Department regularly takes measures for strengthening the quality standards of banking services, development of the effective system for attracting new and maintaining current customers, building up on a capacity of personnel communicating with and providing services to the customers.

Main achievements of PASHA Bank within the recent years are the following:

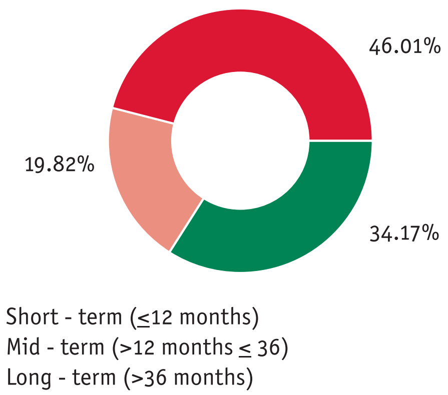
- Implementation of automated banking system – BankSyst;
- Establishment of mechanism for processing customer complaints and suggestions;
- Development of new products meeting customer requirements;
- Establishment of Call Centre system;
- Development and implementation of quality standards for banking services;
- Establishment of customer notification system;
- Development and improvement of credit system.

PASHA Bank provides the following services in order to retain the existing customers and to attract new ones:

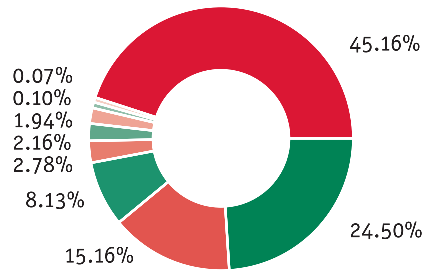
- Standing payment order;
- Settlement and cash services;
- Currency exchange transactions;
- Trade finance operations and loans;
- Deposits;
- Safety deposits boxes;
- Salary projects;
- Inter-bank financing and trade finance transactions;
- Collection services;
- Correspondent accounts;
- Inter-bank collection services;
- Business accounts;
- SMS banking;
- Acquiring;
- Telephone banking.

As compared to previous years, the main direction of the Bank in 2011 was establishing the basis and building the capacity for financing of small and medium enterprises while keeping the corporate sector very much as the other main focus. At the end of 2011 the credit portfolio was 245.4 million manats, which is 26% more than that of the respective period of the previous year. Loans to customers constituted almost 41% of the Bank's total assets). This increase was possible both due to the expanded customer base and refinancing of the existing customers.

46.01% of loans in our credit portfolio are provided as the long-term loans(less than 36 months but more than 12 months), mid-term loans were up to 34.17% and short-term loans (less than 12 months) cover 19.82%

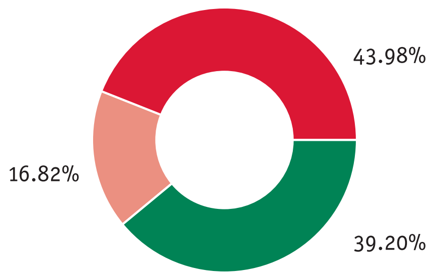


The portfolio was allocated as follows: 45.16% to trade and service sector; 24.5% to manufacturing sector; 15.16% to construction sector and 8.13% to hotel business. Other sectors constitute 7.05% of the portfolio.



- Trade and service
- Manufacturing
- Construction
- Hotel Business
- Agriculture
- Transport and Telecommunication
- Individual
- Energy
- Other

Over 43.98% of loans were provided with collateral, where the collateral amount is equal or less than 150% of loan,16.82% loans are provided with partly collateral and 39.2% without collateral. By the type of collateral 24.52% of loans were disbursed under the collateral of immovable property and land.



- With collateral (≥ 150% of the loan amount)
- Without collateral
- Partly collateral (0-150% of the loan amount)

The Bank offers credit products tailored to the customer needs. The business credits are intended for small and medium enterprises, as well as for large customers engaged in the following areas:

- Agriculture and food industry;
- Hotel management, tourism and leisure;
- Telecommunication;
- Services for oil industry;
- FMCG (Daily consumer goods);
- Trade and service;
- Road construction;
- Construction;
- Manufacture.

Corporate Governance

Internal audit

Based on the best international practices, the Internal Audit Department completed the project on establishment of a new methodological framework (Policy and Procedures) based on a risk-oriented modern approach in May 2011. In November 2011 the Bank invited the Big Four consultants and started the audit of Information Technologies that will be completed in March 2012.

In December 2011 the new revision of the Internal Audit Department Charter was prepared.
The main purpose of the Department was and still is to establish a stable team of efficient specialists. Department personnel continuously work on improvement of qualification level by participating in various trainings, workshops and conferences.

In accordance with 2011 plan, prepared on the basis of main risks and approved by the Audit Committee the following business processes were performed: Large Construction Projects, Financing and Credit Monitoring, Customer Services and Personnel Management. The existing control procedures and their operational efficiency were assessed and recommendations were given with regard to the improvement of internal control procedures and minimisation of the present risks. 10 post-audits were performed in order to monitor the action plans on implementation of audit recommendations.

The Department's main objective for the strategic period is to ensure the highest efficiency level of the internal audit of issues like improvement of shareholder value and to ensure the high satisfaction level of the users interested in the results (and process) of internal audit activities.

Human resources

In 2011 more than 60 employees of the Bank participated in intensive training programs in various European and American training centres in order to improve their professional level. In addition, 10 employees of the Bank attended the training specifically organised by Switzerland ISFB centre for improvement of the operation of PASHA Bank Private Banking department and were the first in Azerbaijan to receive relevant certificates.

In addition to participation in trainings abroad, almost all employees of PASHA Bank benefited from workshops and trainings organised by the training centres in the country.

In 2010 three employees of the Bank continued their education in Great Britain with financial support of the Bank and returned to work in the Bank in November 2011 to implement the knowledge received in the leading educational institutions.

As compared to the end of 2010, the number of employees of the Bank increased by 41 persons and as of December 2011 the Bank staff numbered 148.

In addition to the social responsibility program of the Bank, the Bank employees have established PASHA Bank Rotary Club at their own expense, which considered the regular visits to orphanages under their patronage and attempts to meet their needs.

Risk management

PASHA Bank Board of Directors monitors the structure of the internal control and undertakes main risk management, as well as the approval of the transactions with a potential to damage essential part of the capital.

- Risk Management Committee is responsible for realization of measures for monitoring and risk reduction, as well as for control of defined risk parameters. It always consults (whom with???) on the development of risk management structure, its quality and the relevant statutory requirements.

Risk Management Department is responsible for the activity of risk management system, ensures performance of the main risk management principles and risk reduction and submits reports.

Risk Management Department is also responsible for overseeing internal control structure, assesses

adequacy of risk management and also monitors the performance of policy and statutory requirements.
Credit risks, market and liquidity risks are managed by the Department of Treasury and Financial Markets, Risk Management Department, Loans Control Department, Credit Committee and Assets and Liabilities Management (ALCO) Systems.

In order to make effective decisions and depending on risk type and magnitude, PASHA Bank implemented hierarchical system of departments approving the contract and relevant limits for each such department.

The Loans Control Department deals with the credit risks related to corporate customers.

The Department of Treasury and Financial Markets controls the liquidity risks, as well as credit risks related to the financial entities.

Although risk assessment, reporting and control procedures of PASHA Bank differ depending on the risk types, they are combined in a general methodology developed and revised by the Risk Management Department.

This methodology is supported by inter-bank compliance and regular assessments performed by the Internal Audit Department. The results are discussed with concerned unit managers and then submitted to the Audit Committee and Supervisory Board of PASHA Bank.

This approach takes the aggregate of the Bank obligations and requirements as total risk value of financial tools, which are mutually related but characterised with different ratio of profitability and risk.

Total risk value is defined with procedures assessing Bank portfolio stability force and targeted credit rating is calculated with necessary accuracy.

The main objective of PASHA Bank in establishment of risk management systems is to identify optimal balance between profitability and risk at the Bank level and in accordance with general strategy and corporate management system, as well as to maintain the general insolvency risk as low as practically acceptable.

Risk Management measures cover all processes within the Bank in order to minimise the level of the risks encountered by the Bank.
Considering all the above, in 2011 PASHA Bank continued the risk management activities, as well as establishment of effective system for optimisation of internal control systems at business processes level.

The bank started the establishment of universal risk management system for these purposes. Main objectives of the universal system are:
- Increase of the reliability of the Bank and improvement of existing internal control;
- Improvement of risk management efficiency on the basis of performance indicators of the customer service departments of the Bank;
- Improvement of the professional Bank image among the foreign partners and business counterparts;
- Forecast of the bank activity and strengthening and development of stability in crisis conditions.

We started the implementation of Integrated Risk Management Models developed by COSO (The Committee of Sponsoring Organisations of the Treadway Commission) within the framework of single risk management system with the help of the world-known reputable audit and consultation firm.

Within the framework of the said models, the personnel of the Bank have developed and started implementation of business processes integrating the activities of all structural units both at the risk management and the Bank level in general. The extensive database of Ernst and Young covering the most advanced practice and knowledge of experts in banking sphere, risk management, establishment of internal control system as well as risk management processes was used to that effect.

The description of risk management services covers the following:
- Roles and duties of the risk management departments and the Bank in general at business processes level;
- Comprehensive and consistent approach to the identification, assessment, management, control and accountability of risks;

- Connection of new processes with existing business processes of the Bank (for example, planning, budgeting, capital allocation, assessment, management reports, etc.);
- Main risk factors and their levels, identified risk, procedures and information about risks for the Bank management, monitoring and reporting on communications;
- Monitoring and reporting instructions about main risk factors and risks identifying their levels and delivery of the information on risks required for management of the Bank at appropriate level.

Compilance

In order to ensure more effective operation of the Compliance Department, which was one of the first established in the country's banking sector, the department staff participated in a number of trainings and courses. The department director, who participated in Compliance courses organised by Agence de Transfert de Technologie Financière / ATTF and The Luxembourg Bankers Association / ABBL successfully passed the exam and became one of the first Azerbaijani bankers receiving a professional certificate of competency in the field of compliance.

The department organised number of trainings and presentations for the Bank employees. For example, the training on "Implementation of compliance function in PASA Bank" organised for the Bank management and departments' heads.

The Bank with the Support of Compliance department has carried out the assessment of the compliance risks and prepared Compliance Program for 2011-2013.

The department together with USAID organised a number of training courses for the employees of the bank covering various compliance subjects.

On November 10, 2011 the department organised the presentation "On tax enquiries" for the employees directly working with the customers. The presentation explained how to review, prepare and submit the enquiries received from the Ministry of Taxes.

The department organised training "On anti-money laundering and anti-terrorist financing" for employees directly working with the customers.

Implementation of the advanced technologies in anti-money laundering (AML) actions was one of the objectives of the department. Thus, in order to ensure the transparency of all transactions of the Bank the department reviewed the Safewatch software of Easnets company and signed a contract with Profix company for purchase of filtering module.

Corporate Social Responsibility (CSR)

In 2011 PASHA Bank - one of the leading financial institutions of the country has realised a number of successful projects within its CSR program. One of the objectives set by PASHA Bank within the framework of its CSR mandate is to promote Azerbaijan culture, cultural heritage of our nation and its preservation for future generation. The bank also stakes on the Azeri youth as a driving force of our country and society.

Therefore the 3rd international children's mugam festival organised in October 2011 with the sponsorship of PASHA Bank fully met our aspirations. Young musicians from Turkey, Egypt, Uzbekistan and Turkmenistan took part in this international event of special importance for our country and demonstrated their abilities to the fastidious Azeri audience.

The Bank together with Norwegian Embassy organised an essay competition among the 2nd and 3rd grade university students on the subject of "Corporate reputation:, why the reliability of companies is so important". The main objective of the project was to foster corporate management and integrity concepts among the future professionals. PASHA Bank has financed education of the winners at the prestigious International Business School in Norway.

"PASHA Bank" OJSC and Junior Achievement Azerbaijan successfully implemented joint project "Banks in Action". "Banks in Action" project is one of numerous programs of Junior Achievement Azerbaijan directed at increasing the economical literacy of youth.

This project which was aimed at university students clarifies for them the main financial concepts, gives them the opportunity to learn about history of banking and banking operations, creates opportunities for the students to progress in the careers in financial sector. The project also teaches the youth to become knowledgeable consumers and responsible citizens.

PASHA Bank, within its social responsibility program, pays special attention to healthy development of young generation, formation of positive viewpoint, confidence in future. Therefore we pay special attention to the development of tennis – one of the widespread, fine, yet democratic sports.

Aiming to promoting healthy lifestyle we have organised PASHA Bank Cup European Tennis Tournament among the youth. It gathered 115 young sportsmen from 15 countries. Participants from Russia, Ukraine, Byelorussia, Georgia, Moldova, Kazakhstan, Macedonia, Bulgaria, Belgium, Turkey, Czech Republic, Luxemburg, Austria and Great Britain competed in two age groups (14 and 16). The tournaments financed by PASHA Bank were organised at very high level and gave an opportunity to the students of Baku Tennis Academy to gain experience in international tournaments.

Financing of the tournament held right after the PASHA Bank Cup and dedicated to the memory of the national leader Heydar Aliyev is another example of special attention of PASHA Bank to this sport.

One of the projects proudly financed by PASHA Bank is a training program on business and financial journalism organised together with British Council, Azerbaijan Media Centre and Reuter's Thompson Foundation. The project was intended for increase the professional knowledge and skills of the national media representatives (TV, printed and electronic media) in business and financial journalism.

After one year training in the courses organised by Thompson Foundation and taught by the leading English business media representatives – 7 journalists will visit England in 2012 for short trainings to BBC, Guardian and other well-known media companies.

In general, PASHA Bank pays special attention to education projects and together with State Securities Committee of the Republic of Azerbaijan published collection of articles under the title "Capital markets and business opportunities". This collection of articles was prepared and published within the framework of information and education of public and interested parties on capital markets in accordance with the State Program "On the development of securities market in the Republic of Azerbaijan in 2011-2020" approved by the Decree of the President of the Republic of Azerbaijan in May 16, 2011. This project completely conforming to the PASHA Bank strategy serves for information and education of the population and business community on capital market and transactions in this market and lays foundation for the development of capital market in Azerbaijan and turning Azerbaijan into the regional financial centre. Within the framework of this project PASHA Bank also financed the publication of Capital Markets book in Azeri language for the university students.

One of the events supported by PASHA Bank was the conference organised by the well known economic magazine and conference organiser "The Economist" in Tbilisi in November 17, 2011 and dedicated to the perspective investment opportunities of Georgia.

The overall objective of the organisers of "The Economist" summit was to demonstrate the market potential of Georgia, as well as to present to the foreign investors the opportunities of business activity and make investments in this country. During this event the representatives of Georgian government and investors discussed such important and pressing issues as economical reforms in the country, development of economical potential of the country, increase the attractiveness of the investment environment, etc.

Executive Board

Farid Akhundov

Chairman of the Executive Board
Joined the Bank in 2007. Prior to PASHA Bank worked as Director of FTF Company as well as a Chairman of Executive Board at Bank Standard. In 1996 -2003 held various managerial positions at HSBC Azerbaijan.

Holds MBA degree from Salford University, Manchester, UK.

Rovshan Allahverdiyev

Member of the Executive Board, Deputy Chairman of the Executive Board
Joined the Bank in 2007. Prior to PASHA Bank worked as the Director of Nasimi District Branch in Kapital Bank. From 1992 held various leading positions and was a member of management board in a number of commercial banks in Azerbaijan.
Holds degree from the Leningrad Institute of Finance and Economics.

Emil Hajiyev

Member of the Executive Board, Chief Operations Officer
Joined the Bank in 2007 as a Director of Operations Department. Prior to PASHA Bank worked as a Chief Economist in Payment Systems and Settlements Office and also Headed SWIFT Group in Settlements Department at the Central Bank of Azerbaijan.
Holds degrees in Engineering from Azerbaijan Oil Academy and in Economics from Azerbaijan State University of Economics.

Shahin Mammadov, PhD

Member of the Executive Board, Chief Financial Officer
Joined the Bank in 2009 as a Director of Financial Management department. Prior to PASHA Bank worked at various positions at Deloitte & Touche audit company starting as Associate Auditor and then promoted to the 3rd degree associate auditor, chief audit specialist and audit manager.
Holds Master's degree from Azerbaijan State University of Economics. Was awarded with PhD in Economics in 2010.

Taleh Kazimov

Member of the Executive Board, Chief Investment Officer
Joined the Bank in 2007. Was in charge of risk management, treasury, trade finance and also succeeded in establishing and maintaining strong relationship with international financial community. Prior to joining the Bank Mr. Kazimov held various positions in Bank Standard JSC, Ernst & Young gaining vast experience in investment and corporate banking, financial audit and risk management.
Holds MBA from joint program of ASOA and US Georgia State University majoring in Finance.

Collective bodies functioning in the Bank

Supervisory Board

(Meetings of the Supervisory Board are held twice a month)

- Mir Jamal Pashayev – Chairman;
- Arif Pashayev – member;
- Nariman Sardarli – member.

Executive Board

(Meetings of the Executive Board are held once a week)
- Farid Akhundov – Chairman;
- Rovshan Allahverdiyev – member;
- Emil Hajiyev – member;
- Shahin Mammadov – member;
- Taleh Kazimov – member.

Credit Committee

(Meetings of the Credit Committee are held twice a month)
- Rovshan Allahverdiyev – Chairman;
- Shahin Mammadov – member;
- Taleh Kazımov – member;
- Anar Karimov – member.

Assets and Liabilities Committee (ALCO)

(ALCO meetings are held twice a month)
- Farid Akhundov – Chairman;
- Rovshan Allahverdiyev – member;
- Emil Hajiyev – member;
- Shahin Mammadov – member;
- Taleh Kazimov – member.

Human Resources Committee (HRC)

(HRC meetings are held once a month)
- Farid Akhundov – Chairman;
- Emil Hajiyev – member;
- Sevinj Asadova – member.

Risk Management Committee (RMC)

(RMC meetings are held once a month)
- Farid Akhundov – Chairman;
- Shahin Mammadov – member;
- Taleh Kazimov – member;
- Kamala Nuriyeva – member;
- Sevinj Asadova – member.

Information Technologies Committee (ITC)

(ITC meetings are held once a month)
- Emil Hajiyev – Chairman;
- Rasim Hajiyev – member;
- Elmina Nabiyeva – member;
- Orkhan Taghizadeh – member;
- Fuad Pashayev – member.

OJSC PASHA Bank
Financial Statements

Year ended 31 December 2011

Together with Independent Auditors' Report

Independent auditors' report

To the Shareholders and Board of Directors of OJSC PASHA Bank -

We have audited the accompanying financial statements of OJSC PASHA Bank, which comprise the statement of financial position as at 31 December 2011, and the 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 financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements present fairly, in all material respects, the financial position of OJSC PASHA Bank as at 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

17 February 2012

Ernst & Young Holdings (CIS) B.V.

Statement of financial position, as at 31 December 2011

(in thousands of Azerbaijani Manats)	Notes	31 December 2011	31 December 2010
Assets			
Cash and cash equivalents	5	35,105	132,892
Trading securities	6	24,736	897
Securities purchased under agreements to resell	7	26,932	5,775
Amounts due from credit institutions	8	24,684	22,676
Investment securities available–for–sale	9	209,307	149,400
Investment securities held to maturity	9	-	506
Loans to banks	10	1,500	4,379
Loans to customers	11	234,004	187,868
Property and equipment	12	4,216	3,549
Investment property	13	2,000	-
Intangible assets	14	1,842	1,607
Current income tax assets	20	112	-
Other assets	15	9,442	2,755
Total assets	**573,880**	**512,304**	
Liabilities			
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	16	30,896	24,007
Amounts due to customers	17	371,499	338,599
Amounts due to credit institutions	18	14,107	6,786
Current income tax liability	20	-	573
Deferred income tax liabilities	20	758	-
Provision for guarantees and other commitments	23	1,404	1,582
Other liabilities	15	3,388	3,942
Amount reserved for increase in share capital	19	2,645	-
Total liabilities	**424,697**	**375,489**	
Equity			
Share capital	21	123,475	115,407
Retained earnings		25,717	21,408
Net unrealised losses on investment securities available–for–sale		(9)	-
Total equity		**149,183**	**136,815**
Total liabilities and equity		**573,880**	**512,304**

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

31 March 2010

Statement of comprehensive income, for the year ended 31 December 2011

(in thousands of Azerbaijani Manats)	Notes	Year ended 31 December 2011	Year ended 31 December 2010
Interest income			
Loans to customers		26,817	22,680
Investment securities		5,966	3,741
Amounts due from credit institutions		2,278	5,478
Guarantees and letters of credit		1,557	1,184
Loans to banks		628	741
Trading securities		395	–
Securities purchased under agreements to resell		117	18
		37,758	**33,842**
Interest expense			
Amounts due to customers		(11,059)	(7,844)
Amounts due to credit institutions		(801)	(111)
Guarantees and letters of credit		(478)	(431)
Amounts due to the Central Bank of the Republic of Azerbaijan, Banks and government funds		(459)	(359)
Other		–	(11)
		(12,797)	**(8,756)**
Net interest income		**24,961**	**25,086**
Provision for impairment losses on interest bearing assets		(4,542)	(5,649)
Reversal of provision/(provision) for guarantees and other commitments		178	(801)
Provision for impairment losses on interest bearing assets, guarantees and other commitments	**23**	**(4,364)**	**(6,450)**
Net interest income after provision for impairment losses		**20,597**	**18,636**
Net fee and commission income	24	2,452	1,403
Net gains from trading securities		278	49
Net gains from investment securities available–for–sale			280
Net gains/(losses) from foreign currencies:			
- dealing		3,196	3,750
-translation differences		112	(224)
Other income		38	–
Non–interest income		**6,076**	**5,258**
Personnel expenses	25	(6,110)	(5,680)
General and administrative expenses	25	(4,512)	(2,936)
Depreciation and amortisation	12,14	(901)	(726)
Non–interest expenses		**(11,523)**	**(9,342)**
Profit before income tax expense		**15,150**	**14,552**
Income tax expense	20	(1.791)	(681)
Net profit for the year		**13,359**	**13,871**
Other comprehensive income		–	–
Unrealised losses on investment securities available–for–sale		(11)	–
Deferred tax effect	20	2	–
Other comprehensive income for the year, net of tax		**(9)**	–
Total comprehensive income for the year		**13,350**	**13,871**

Note 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 ("CBA") 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 two service points in Azerbaijan as of 31 December 2011 (2010: two).

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

As of 31 December 2011 and 2010 the following shareholders owned the outstanding shares of the Bank:

Shareholder	31 December 2011 (%)	31 December 2010 (%)
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.

Note 2
Basis of preparation

General

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

The Azerbaijani Manat is the functional and presentation currency of the 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 financial statements in Azerbaijani Manat and in accordance with IFRS.

These financial statements are presented in thousands of Azerbaijani Manat ("AZN"), except per share amounts and unless otherwise indicated.

The 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.

Note 3
Summary of significant accounting policies

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:

IAS 24 "Related party disclosures" (Revised)
The revised IAS 24, issued in November 2009 and effective for annual periods beginning on or after 1 January 2011, simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. Previously, an entity controlled or significantly influenced by a government was required to disclose information about all transactions with other entities controlled or significantly influenced by the same government. The revised standard requires disclosure about these transactions only if they are individually or collectively significant. The disclosure of the transactions with related parties in accordance with the revised Standard is presented in the Note 29.

Amendments to IAS 32 "Financial instruments: Presentation": Classification of Rights Issues"
In October 2009, the IASB issued amendment to IAS 32. Entities shall apply that amendment for annual periods beginning on or after 1 February 2010. The amendment alters the definition of a financial liability in IAS 32 to classify rights issues and certain options or warrants as equity instruments. This is applicable if the rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, in order to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. The amendment had no impact on the Bank's financial statements.

IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments"
IFRIC Interpretation 19 was issued in November 2009 and is effective for annual periods beginning on or after 1 July 2010. The interpretation clarifies the accounting when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor to extinguish all or part of the financial liability. This Interpretation had no impact on the Bank's financial statements.

Improvements to IFRSs
In May 2010 the IASB issued the third omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. Most of the amendments are effective for annual periods beginning on or after 1 January 2011. There are separate transitional provisions for each standard. Amendments included in May 2010 "Improvements to IFRS" had impact on the accounting policies, financial position or performance of the Bank, as described below:

- IFRS 7 Financial instruments: Disclosures; introduces the amendments to quantitative and credit risk disclosures. The additional requirements had minor impact as information is readily available.
- Other amendments to IFRS 1, IFRS 3, IAS 1, IAS 27, IAS 34 and IFRIC 13 had no impact on the accounting policies, financial position or performance of the Bank.

The following amendments to standards and interpretations did not have any impact on the accounting policies, financial position or performance of the Bank:

- IFRS 1 First-time Adoption of International Financial Reporting Standards – Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters
- IFRIC 14 Prepayments of a Minimum Funding Requirement

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 also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognized in the income statement.

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 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 income statement when the loans and receivables are derecognized or impaired, as well as through the amortization process.

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 income statement. However, interest calculated using the effective interest method is recognized in the 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 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 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 CBA, 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 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. 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 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 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 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.

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 other comprehensive income to the income statement. Impairment losses on equity investments are not reversed through the income statement; increases in their fair value after impairment are recognized in 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 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 income statement, the impairment loss is reversed through the 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 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 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.

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 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 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 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. 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 begins when it is 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	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.

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 financial statements are authorised for issue.

Contingencies
Contingent liabilities are not recognised in the 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 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.

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 customer, external manager, brokerage, custodian and foreign currency purchase/sale fees.

Foreign currency translation

The 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 CBA exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies.

The Bank used the following official exchange rates at 31 December 2011 and 2010 in the preparation of these financial statements:

	31 December 2011	31 December 2010
1 US Dollar	AZN 0.7865	AZN 0.7979
1 Euro	AZN 1.0178	AZN 1.0560
1 Russian Rouble	AZN 0.0245	AZN 0.0263
1 Pound Sterling	AZN 1.2123	AZN 1.2377

Future changes in accounting policies

Standards and interpretations issued but not yet effective

IFRS 9 "Financial Instruments"

In November 2009 and 2010 the IASB issued the first phase of IFRS 9 Financial instruments. This Standard will eventually replace IAS 39 Financial Instrument: Recognition and Measurement. IFRS 9 becomes effective for financial years beginning on or after 1 January 2013. The first phase of IFRS 9 introduces new requirements on classification and measurement of financial instruments. In particular, for subsequent measurement all financial assets are to be classified at amortised cost or at fair value through profit or loss with the irrevocable option for equity instruments not held for trading to be measured at fair value through other comprehensive income. For financial liabilities designated at fair value through profit or loss using fair value option IFRS 9 requires the amount of change in fair value attributable to changes in credit risk to be presented in other comprehensive income. The Bank now evaluates the impact of the adoption of new Standard and considers the initial application date.

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 judgement 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. The Bank expects that adoption of IFRS 10 will have no effect on its financial position and performance.

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 financial position and performance.

IFRS 12 Disclosure of Interests in Other Entities

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. IFRS 12 is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

The Bank expects that adoption of IFRS 12 will have no effect on its financial position and 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 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 adoption of IAS 27 will have no effect on its financial position and performance.

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 adoption of IAS 28 will have no effect on its financial position and performance.

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 but not derecognised to enable the user of the Bank's financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendment requires disclosures about continuing involvement in derecognised assets to enable the user to evaluate the nature of, and risks associated with, the entity's continuing involvement in those derecognised assets. The amendment affects disclosure only and has no impact on the Bank's financial position or performance.

Amendments to IAS 12 "Income Taxes" – Deferred tax: Recovery of underlying assets

In December 2010 the IASB issued amendments to IAS 12 effective for annual periods beginning on or after 1 January 2012. The amendment clarified the determination of deferred tax on investment property measured at fair value. The amendment introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale. Furthermore, it introduces the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in IAS 16 always be measured on a sale basis of the asset. The Bank now evaluates the impact of the adoption of these amendments.

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 proposes 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 financial position.

Amendments to IAS 1 Changes to the Presentation of Other Comprehensive Income

The amendments to IAS 1 Presentation of Financial Statements, effective for annual periods beginning on or after 1 July 2012, 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, upon derecognition or settlement) would be presented separately from items that will never be reclassified. These amendments will change presentation in the statement of comprehensive income but will have no effect on its financial position and performance.

Amendment to IFRS 1 Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters

These amendments to IFRS 1, effective for annual periods beginning on or after 1 July 2011, introduce a new deemed cost exemption for entities that have been subject to severe hyperinflation. The Bank expects that these amendments will have no impact on the Bank's financial position.

Note 4
Significant accounting judgments and estimates

Allowance for loan impairment
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 financial statements:

Fair value of financial instruments
Where the fair values of financial assets and financial liabilities recorded in the 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 2011 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.

Note 5
Cash and cash equivalents

Cash and cash equivalents comprise:

	31 December 2011	31 December 2010
Cash on hand	4,594	5,611
Current accounts with the Central Bank of the Republic of Azerbaijan	10,894	78,458
Current accounts with other credit institutions	13,870	19,348
Time deposits	5,747	29,475
Cash and cash equivalents	35,105	132,892

Current accounts with other credit institutions consist of non–interest bearing correspondent account balances with resident and non–resident banks in the amount of AZN 8,818 thousands (2010–AZN 18,719 thousands) and AZN 5,052 thousands (2010–AZN 629 thousands), respectively.

As of 31 December 2011 the Bank placed AZN 5,747 thousands (2010–AZN 29,475 thousands) in time deposits with non-resident bank (2010–resident and non–resident banks) maturing on 5 January 2012 (2010–22 February 2011) and with effective annual interest rate of 0.1% (2010–0.3%-15.0%).

Non-cash transaction performed by the Bank during 2011 is represented by capitalization of net profit for the year 2010 (2010–for the year 2009) to share capital in the amount AZN 8,068 thousands (2010–AZN 15,407 thousands).

Note 6
Trading securities

Trading securities comprise:

	31 December 2011		31 December 2010	
	Annual interest rate	Carrying value	Annual interest rate	Carrying value
Corporate bonds issued by Unibank Commercial Bank OJSC	11.00%	9,784	-	-
Corporate bonds issued by Bakcell LTD	9.50%	6.682	-	-
Eurobonds of Akbank TAS	5.13%	3,010	-	-
Corporate bonds issued by "Unileasing" Leasing Company CJSC	9.50%–10.00%	1,017	-	-
Equity securities held by Citadele Banka JSC, external asset manager	-	720	-	897
T-bills of Hellenic Republic	4.30%	523	-	-
Trading securities		24.736		897

The Bank placed investments with Citadele Banka JSC, an external asset manager, and appointed it as its agent and delegated it to manage the investment and reinvestment of certain monies and assets. It also entered into a Custodian Agreement with the same external asset manager to serve as the Custodian of the investment portfolios. The funds and assets are held by the Custodian, which monitors portfolios and is provided by the Bank the authority to release or deliver securities of the portfolio, register securities, and conduct transactions based on the asset manager's requests on buy/sell decisions. The Custodian provides the Bank a monthly report of all monies received in respect of the portfolio or paid out of the portfolio. The assets placed with the external manager can be recalled by the Bank upon 20 days' written notice in advance.

The external asset manager, acting as an agent, has complete discretion but within the set of investment guidelines prescribed by the Bank, for the account of the Bank to buy, sell, retain, exchange or otherwise deal in investments and other assets, make deposits, subscribe to issues and offers for sale, and accept placements, underwritings and sub-underwritings, of any investments, advise on or execute transactions in unregulated collective investment schemes, effect transactions on all markets, negotiate and execute counterparty and account opening documentation, take all day to day decisions and otherwise act as the external manager judge appropriate in relation to the management of the funds.

Trading securities held and managed by Citadele Banka JSC, the Bank's external manager, amounted to AZN 720 thousands as of 31 December 2011 (2010–AZN 897 thousands), and are comprised of US Dollar, Euro and Norwegian Crone denominated corporate shares traded internationally.

The Bank launched market maker service activities and signed related agreements with three local companies. As of 31 December 2011 the Bank had trading securities under these agreements amounting to AZN 20,483 (2010–nil).

Note 7
Securities purchased under agreements to resell

As of 31 December 2011 the Bank had entered into agreements to resell short-term notes issued by the CBA with total fair value of AZN 26,932 thousands (2010–AZN 5,775 thousands) to a resident credit institution. The agreement matures on 5 January 2012 (2010–4 January 2011) with annual effective interest rate at 1% (2010–1%).

Note 8
Amounts due from credit institutions

Amounts due from credit institutions comprise:

	31 December 2011	31 December 2010
Time deposits	19,697	19,947
Obligatory reserve with the Central Bank of the Republic of Azerbaijan	4,983	836
Blocked deposits	4	1,893
Amounts due from credit institutions	24,684	22,676

As of 31 December 2011, AZN 16,353 thousands or 83% of total time deposits (2010–AZN 13,075 thousands or 66% of total time deposits) was placed on inter-bank deposits with two (2010–three) local and one non resident (2010–nil) commercial banks maturing through 21 May 2012 (2010–20 September 2011) and with effective annual interest rate of 6%-12% (2010–7%-19%).

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBA at 2% and 3% (2010–0.5%) 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.

Note 9
Investment securities

Available-for-sale securities comprise:

	31 December 2011		31 December 2010	
	Carrying value	Nominal value	Carrying value	Nominal value
Notes issued by the Azerbaijan Mortgage Fund	163,695	160,992	34,737	34,668
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	11,952	11,997	47,428	47,681
Treasury bills issued by the Ministry of Finance of the Republic of Azerbaijan	33,357	33,632	62,239	62,573
Corporate bonds issued by FinansLizinq Open Joint Stock Company (OJSC)	303	303	-	-
Notes issued by the Central Bank of the Republic of Azerbaijan	-	-	4,996	5,001
Investment securities available-for-sale	209,307	206,924	149,400	149,923

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

	31 December 2011		31 December 2010	
	%	Maturity	%	Maturity
Notes issued by Azerbaijan Mortgage Fund	3.0%–3.25%	May 2016 – December 2019	3.0%	May 2016
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	2.5% - 2.99%	February 2012 – May 2012	1.46%–2.99%	January 2011 – May 2011
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	3.98% - 7.00%	March 2012 – December 2012	3.75%–6.9%	January 2011 – May 2011
Corporate bonds issued by FinansLizinq Open Joint Stock Company (OJSC)	15.0%	December 2012	15.0%	December 2012
Notes issued by the Central Bank of the Republic of Azerbaijan	-	-	1.99%-2.2%	January 2011

Held to maturity securities comprise:

	31 December 2011	31 December 2010
Corporate bonds issued by FinansLiziniq Open Joint Stock Company (OJSC)	-	303
Corporate bonds issued by Azel Closed Joint Stock Company (CJSC)	-	213
	-	516
Less–Allowance for impairment (Note 23)	-	(10)
Held to maturity securities	-	506

Reclassifications

During 2011 the Bank reclassified corporate bonds issued by OJSC FinansLizinq in the amount of AZN 303 thousands and corporate bonds issued by CJSC Azel in the amount of AZN 105 thousands out of held to maturity category to available-for-sale. The reason for reclassification is sale of the more than insignificant amount of held–to–maturity investments before maturity. No fair value gain orloss has been recognized on the reclassified assets as the fair value of these assets approximated the carrying value at the time of reclassification. Corporate bonds issued by OJSC FinansLizinq are AZN–denominated coupon bonds with annual interest rate of 15.0%. Bonds mature on 18 December 2012. The interest on these securities is repaid monthly. Corporate bonds issued by CJSC Azel matured on 15 July 2011.

Note 10
Loans to banks

As of 31 December 2011 the Bank had outstanding amount of AZN 1,500 thousands (2010–AZN 4,379 thousands) of unsecured loan denominated in Azerbaijani Manat and US dollar, issued to one (2010–two) resident commercial bank with contractual maturity through April 2012 (2010–April 2011 and May 2012) and annual interest rate of 11% (2010–16%).

Note 11
Loans to customers

Loans to customers comprise:

	31 December 2011	31 December 2010
Legal entities	241,970	191,497
Individuals	4,799	4,584
Loans to customers (gross)	246,769	196,081
Less–Allowance for impairment (Note 23)	(12,765)	(8,213)
Loans to customers (net)	246,769	187,868

	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

	Corporate lending 31 December 2010	Individual lending 31 December 2010	Total 31 December 2010
Individual impairment	(7,005)	(314)	(7,319)
Collective impairment	(831)	(63)	(894)
	(7,836)	(377)	(8,213)
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	9,650	433	10,083

Loans are made within Azerbaijan in the following industry sectors:

	31 December 2011	31 December 2010
Trade and services	111,430	85,324
Manufacturing	60,450	39,961
Construction	37,417	35,180
Hotel business	20,057	20,049
Agriculture and food processing	6,861	3,855
Transport and telecommunication	5,336	3,630
Individuals	4,798	4,584
Energy	255	-
Leasing	-	3,338
Leasing	165	160
Total loans (gross)	246.769	196,081

As of 31 December 2011, the Bank granted loans to 8 customers (2010–10 customers) totalling AZN 130,583 thousands (2010–AZN 139,103 thousands), which individually exceeded 5% of the Bank's equity.

Note 12
Property and equipment

The movements in property and equipment were as follows:

	Buildings	Furniture and fixtures	Computers and other equipment	Vehicles	Other equipment	Leasehold improvements	Total
Cost							
31 December 2009	-	851	710	298	33	98	1,990
Additions	2,151	249	158	128	4	10	2,700
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
Accumulated depreciation							
31 December 2009	-	(256)	(193)	(125)	(9)	(7)	(590)
Depreciation charge	-	(222)	(205)	(102)	(6)	(16)	(551)
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)
Net book value:							
31 December 2011	2,151	812	556	614	14	59	4,216
31 December 2010	2,151	622	470	199	22	85	3.549

Note 13
Investment property

During the year 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 2011 the fair value of this investment property amounted to AZN 1,920 thousands.

Note 14
Intangible assets

The movements in intangible assets were as follows:

	Licenses	Computer software	Installations in progress	Total
Cost 31 December 2009	288	200	283	771
Additions	143	927	-	1,070
Disposals	(55)	-	-	(55)
Transfers	-	283	(283)	-
31 December 2010	376	1,410	-	1,786
Additions	24	436	-	460
31 December 2011	400	1,846	-	2,246
Accumulated amortization 31 December 2009	(45)	(14)	-	(59)
Amortisation charge	(80)	(95)	-	(175)
Disposals	55	-	-	55
31 December 2010	(70)	(109)	-	(179)
Amortisation charge	(61)	(164)	-	(225)
31 December 2011	(131)	(273)	-	(404)
Net book value: 31 December 2011	269	1,573	-	1,842
31 December 2010	306	1,301	-	1,607

Note 15
Other assets and liabilities

Other assets comprise:

Other financial assets	31 December 2011	31 December 2010
Settlements on money transfers	206	32
Accrued interest receivable on guarantees and letters of credit	75	127
	281	159
Other non–financial assets		
Prepayments for acquisition of property, equipment	6,217	2,235
Receivable from the Ministry of Taxes (Note 19)	2,467	-
Deferred expenses	418	321
Other	59	40
	9,161	2,596
Other assets	9,442	2,755

As of 31 December 2011 prepayments for the purchase of property, equipment and intangible assets of AZN 6,217 thousands (2010–AZN 2,235 thousands), related to premises for the Bank's new branches located in Baku and regions of the Republic of Azerbaijan.

Other liabilities comprise:

Other financial liabilities	31 December 2011	31 December 2010
Dividends payable (Note 21)	982	981
Payable to employees	195	113
Settlements on money transfer	72	36
Payables for professional services	56	64
Payables on social security costs	43	25
Accrued expenses	20	14
Accrued interest payables on letters of credit	12	36
Other	1	-
	1,381	1,269
Other non–financial liabilities		
Accrued staff bonuses	1,525	1,500
Deferred income	482	49
Taxes, other than income tax	-	1,124
	2,007	2,673
Other liabilities	3,388	3,942

Note 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:

Other financial assets	31 December 2011	31 December 2010
Loans from the National Fund for Support of Entrepreneurship	19,971	13,635
Loans from the Central Bank of the Republic of Azerbaijan	10,000	10,000
Amount due to Azerbaijan Mortgage Fund	921	369
Correspondent accounts with other banks	4	3
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	30,896	24,007

As of 31 December 2011 the Bank had fourteen loans (2010–seven loans) from the National Fund for Support of Entrepreneurship amounting to AZN 19,971 thousands (2010–AZN 13,635 thousands), maturing through 2016 (2010– through 2015), 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 (2010–7% p.a.) with maturities through December 2016 (2010–October 2015).

As of 31 December 2011 the Bank had loans from the Central Bank of the Republic of Azerbaijan amounting to AZN 10,000 thousands (2010–AZN 10,000 thousands), maturing through December 2012 (2010–February 2012) and bearing annual interest rate of 2.5%–6.00% (2010–2.5%)

As of 31 December 2011 the Bank had twenty two loans (2010–eight loans) refinanced from the Azerbaijan Mortgage Fund amounting to AZN 921 thousands (2010–AZN 369 thousands), maturing through 2036 (2010–through 2035) and bearing annual interest rate of 4.0%.

Note 17
Amounts due to customers

The amounts due to customers include the following:

Other financial assets	31 December 2011	31 December 2010
Demand deposits	205,625	191,519
Time deposits	165,874	147,080
Amounts due to customers	371,499	338,599
Held as security against guarantees	56	967

An analysis of customer accounts by economic sector follows:

	31 December 2011	31 December 2010
Individuals	170,341	102,226
Investment holding companies	125,897	181,762
Construction	38,218	22,342
Trade and services	28,847	17,043
Manufacturing	2,873	2,256
Insurance	2,414	7,356
Agriculture	684	4
Transport and comamunication	511	205
Energy	32	5,178
Other	1,682	227
Amounts due to customers	371,499	338,599

As of 31 December 2011 customer deposits included balances with five largest customers amounting to AZN 262,902 thousands (2010–AZN 257,909 thousands). These deposits comprise significant concentration of approximately 71% (2010–76%) of the total customer deposits portfolio.

As at 31 December 2011 time deposits amounting to AZN 56 thousands (2010–AZN 967 thousands) were held as security against guarantees issued (Note 22).

Note 18
Amounts due to credit institutions

Amounts due to credit institutions comprise:

	31 December 2011	31 December 2010
Commerzbank Aktiengesellschaft	7,814	4,162
Raiffeisen Bank International Aktiengesellschaft	3,302	1,330
Landesbank Baden-Württemberg	2,991	1,294
Amounts due to credit institutions	14,107	6,786

As of 31 December 2011 amounts due to credit institutions included balances with 3 foreign banks amounting to AZN 14,107 thousands (2010–AZN 6,786 thousands), maturing through 2012 (2010–through 2011) and bearing interest rate of 3.64%–6.94% p.a (2010–2.72%–5.96% p.a.) These unsecured borrowings are for trade finance of import operations (letters of credit) of the customers of the Bank.

Note 19
Amount reserved for increase in share capital

As of 31 December 2011 amount reserved for increase in share capital amounted to AZN 2,645 thousands. During prior year the Tax Authorities applied 10% dividend tax to the amounts of capitalized profit (under the assumption that the profit is initially distributed as a dividend and subsequently capitalized) for all commercial banks in the Republic of Azerbaijan. The Bank has deducted and paid to tax authorities 10% of dividend tax for 2009 and 2010 in the amounts of AZN 1,541 thousands and KAZN 1,104 thousands, respectively. However, during current year the Constitutional Court of the Republic of Azerbaijan has found application of this dividend tax unlawful and cancelled it. Based on this, the Bank prepared and sent revised withholding tax declaration and recognized this amount as tax receivable (which is being used for settlement of future tax obligations of the Bank) with a corresponding credit to amount reserved for increase in share capital. The bank made decision to use these amounts for share capital increase together with the 90% portion of current year statutory profit.

Note 20
Taxation

The corporate income tax expense comprises:

	Year ended 31 December 2011	Year ended 31 December 2010
Current tax charge	(1,031)	(681)
Deferred tax charge	(760)	-
Income tax expense	(1,791)	(681)

In accordance with the Law of the Republic of Azerbaijan on enhancement of activities of banks, insurance and reinsurance companies (N710–IIIQ and dated 28 October 2008), financial institutions are exempt from payment of Profit Tax starting from 1 January 2009 for a period of 3 consecutive years, if the current year profit is capitalized. The Bank has intention to capitalize 90% of the current year profit. The remaining part of the profit is declared as dividend to shareholders and subject for profit tax. During the previous two years the Bank did not recognize deferred tax considering the fact that temporary differences, which are potentially subject to deferred tax, are utilized during the tax exemption period.

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

	Year ended 31 December 2011	Year ended 31 December 2010
Net losses on investment securities available–for–sale	2	-
Income tax credited to other comprehensive income	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 2011	Year ended 31 December 2010
Profit before income tax expense	15,150	14,552
Statutory tax rate	20%	20%
Theoretical tax expense at the statutory rate	(3,030)	(2,910)
Tax effect of non–deductible expenses	(300)	(328)
Unrecognized deferred tax liabilities as result of capitalization	(671)	-
Tax effect of tax–exempt income arising from capitalization of profit	2,210	2,557
Income tax expense	(1,791)	(681)

As of 31 December 2011 the Bank has current income tax receivable of AZN 112 thousands (2010–payable amounted to AZN 573 thousands).

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		
Tax effect of deductible temporary differences:	2009	In the income statement	In other comprehensive income	2010	In the income statement	In other comprehensive income	2011
Investment securities available–for–sale	-	-	-	-	-	2	2
Loans to customers	-	-	-	-	148	-	148
Property and equipment	-	-	-	-	32		32
Other liabilities	-	-	-	-	464		464
Deferred tax asset	-	-	-	-	644		646
Tax effect of taxable temporary differences:							
Amounts due from credit institutions	-	-	-	-	(59)		(59)
Loans to banks	-	-	-	-	(6)		(6)
Loans to customers	-	-	-	-	(891)		(891)
Provision for contingent liabilities	-	-	-	-	(428)		(428)
Intangible assets	-	-	-	-	(20)		(20)
Deferred tax liability	-	-	-	-	(1,404)		(1,404)
Net deferred tax liability	-	-	-	-	(760)	2	(758)

Note 21
Equity

The share capital of the Bank was contributed by the shareholders in AZN and they are entitled to dividends and any capital distribution in AZN. On 24 December 2010, the shareholders of the Bank declared dividends of AZN 981 thousands from the 2010 net profit of the Bank and was accrued accordingly as of 31 December 2010. These dividends were paid to the shareholders of the Bank on 5 December 2011.

On 19 January 2011 the shareholders decided to increase the share capital 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. In 2010 share capital was increased by AZN 15,407 thousands from AZN 100,000 thousands to AZN 115,407 thousands through capitalization of the profit earned, for the year ended 31 December 2009.

On 5 December 2011, the shareholders of the Bank declared dividends of AZN 982 thousands from the 2011 net profit of the Bank and was accrued accordingly as of 31 December 2011. These dividends were not paid to the shareholders of the Bank as of 31 December 2011.

As of 31 December 2011 the Bank authorized, issued and fully paid capital amounted to AZN 123,475 thousands (31 December 2010–AZN 115,407 thousands) and comprised 10,000 ordinary shares with a par value of AZN 12,347.47 per share (31 December 2010–AZN 11,540.71). Each share entitles one vote to the shareholder.

Note 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 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.

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 2011 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.

Financial commitments and contingencies comprise:

	31 December 2011	31 December 2010
Credit–related commitments		
Unused credit lines	27,061	6,759
Guarantees issued	16,526	19,958
Letters of credit	13,056	10,372
	56,643	37,089
Operating lease commitments		
Not later than 1 year	276	337
Later than 1 year but not later than 5 years	983	1,352
Later than 5 years	600	599
	1,859	2,288
Less–Provisions (Note 23)	(1,404)	(1,582)
Commitments and contingencies (before deducting collateral)	57,098	37,795
Less–Cash held as security against letters of credit and guarantees (Note 17)	(56)	(967)
Commitments and contingencies	57,042	36,828

Note 23
Impairment losses on interest bearing assets, and provision for guarantees and other commitments

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

Year ended 31 December 2011						
	Corporate lending	Individual lending	Total loans to customers	Investment securities held to maturity	Guarantees and other commitments	Total allowances and provisions
At 1 January	(7,836)	(377)	(8,213)	(10)	(1,582)	(9,805)
(Charge)/reversal for the year	(4,505)	(47)	(4,552)	10	178	(4,364)
At 31 December	(12,341)	(424)	(12,765)	-	(1,404)	(14,169)

Year ended 31 December 2010						
	Corporate lending	Individual lending	Total loans to customers	Investment securities held to maturity	Guarantees and other commitments	Total allowances and provisions
At 1 January	(2,208)	(352)	(2,560)	(14)	(781)	(3,355)
(Charge)/reversal for the year	(5,628)	(25)	(5,653)	4	(801)	(6,450)
At 31 December	(7,836)	(377)	(8,213)	(10)	(1,582)	(9,805)

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

Note 24
Net fee and commission income

	Year ended 31 December 2011	Year ended 31 December 2010
Currency conversion operations	1,108	734
Settlements operations	850	694
Cash operations	531	367
Securities operations	495	-
Servicing plastic card operations	298	109
Guarantees and commitments	113	55
Other	2	106
Fee and commission income	3,397	2,065
Servicing plastic card operations	(304)	(74)
Settlements operations	(262)	(214)
Securities operations	(237)	(276)
Guarantees and commitments	(101)	(50)
Currency conversion operations	(23)	(27)
Cash operations	(6)	(4)
Other	(12)	(17)
Fee and commission expense	(945)	(662)
Net fee and commission income	2,452	1,403

Note 25 Personnel, general and administrative expenses

Personnel expenses comprise:

	Year ended 31 December 2011	Year ended 31 December 2010
Salaries and bonuses	(4,230)	(4,382)
Social security costs	(1,029)	(979)
Other employee related expenses	(851)	(319)
Total personnel expenses	(6,110)	(5,680)

General and administrative expenses comprise:

	Year ended 31 December 2011	Year ended 31 December 2010
Charity and sponsorship	(1,140)	(650)
Professional services	(1,033)	(662)
Advertising costs	(526)	(381)
Transportation and business trip expenses	(446)	(315)
Software cost	(341)	(80)
Operating leases	(278)	(112)
Insurance	(157)	(97)
Communications	(99)	(63)
Security expenses	(90)	(62)
Repair and maintenance	(51)	(52)
Utilities	(49)	(34)
Taxes, other than income tax	(48)	(126)
Stationery	(46)	(26)
Membership fees	(24)	(18)
Printing expenses	(23)	(16)
Other expenses	(161)	(242)
Total general and administrative expenses	(4,512)	(2,936)

Note 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.

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.

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 table below shows the maximum exposure to credit risk for the components of the statement of financial position. The maximum exposure is shown net, after the effect of mitigation through the use of master netting and collateral agreements.

	Notes	Gross maximum exposure 31 December 2011	Gross maximum exposure 31 December 2010
Cash and cash equivalents (excluding cash on hand)	5	30,511	127,281
Trading securities	6	24,736	897
Securities purchased under agreements to resell	7	26,932	5,775
Amounts due from credit institutions	8	24,684	22,676
Investment securities available–for–sale	9	209,307	149,400
Investment securities held to maturity	9	-	506
Loans to banks	10	1,500	4,379
Loans to customers	11	234,004	187,868
Other financial assets	15	281	159
		551,955	498,941
Financial commitments and contingencies	22	55,183	34,540
Total credit risk exposure		607,138	533,481

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.

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 statement of financial position lines, based on the Bank's credit rating system.

		Neither past due nor impaired					
	Notes	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

		Neither past due nor impaired					
	Notes	High grade 2010	Standard grade 2010	Sub-standard grade 2010	Past due but not impaired 2010	Individually impaired 2010	Total 2010
Securities purchased under agreements to resell	7	5,775	-	-	-	-	5,775
Amounts due from credit institutions	8	-	22,676	-	-	-	22,676
Investment securities available–for–sale	9	149,400	-	-	-	-	149,400
Investment securities held to maturity	9	-	516	-	-	-	516
Loans to banks	10	-	4,379	-	-	-	4,379
Loans to customers	11						
Corporate lending		177,742	-	-	4,105	9,650	191,497
Individual lending		3,209	-	-	942	433	4,584
Total		336,126	27,571	-	5,047	10,083	378,827

Past due loans to customers include those that are only past due by a few days. An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

	Less than 30 days 2011	31 to 60 days 2011	61 to 90 days 2011	More than 90 days 2011	Total 2011
Loans to customers					
Corporate lending	-	-	-	-	-
Individual lending	-	-	-	-	-
Total	-	-	-	-	-

	Less than 30 days 2010	31 to 60 days 2010	61 to 90 days 2010	More than 90 days 2010	Total 2010
Loans to customers					
Corporate lending	38	-	-	4,067	4,105
Individual lending	215	-	-	727	942
Total	253	-	-	4,794	5,047

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.

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 2011				31 December 2010			
	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	24,323	10,707	75	35,105	105,488	27,396	8	132,892
Trading securities	20,483	4,226	27	24,736	-	871	26	897
Securities purchased under repurchase agreements	26,932	-	-	26,932	5,775	-	-	5,775
Amounts due from credit institutions	19,662	336	4,686	24,684	14,419	2,132	6,125	22,676
Investment securities available–for–sale	209,307	-	-	209,307	149,400	-	-	149,400
Investment securities held to maturity	-	-	-	-	506	-	-	506
Loans to banks	1,500	-	-	1,500	4,379	-	-	4,379
Loans to customers	234,004	-	-	234,004	187,868	-	-	187,868
Other financial assets	174	107	-	281	159	-	-	159
	536,385	15,376	4,788	556,549	467,994	30,399	6,159	504,552

	31 December 2011				31 December 2010			
	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 liabilities:								
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	30,896	-	-	30,896	24,007	-	-	24,007
Amounts due to customers	371,499	-	-	371,499	338,599	-	-	338,599
Amounts due to credit institutions	-	14,107	-	14,107	-	6,786	-	6,786
Other financial liabilities	1,366	15	-	1,381	1,269	-	-	1,269
Amount reserved for increase in share capital	2,645	-	-	2,645	-	-	-	-
	406,406	14,122	-	420,528	363,875	6,786	-	370,661
Net assets	129,979	1,254	4,788	136,021	104,119	23,613	6,159	133,891

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 CBA, 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 CBA. As at 31 December 2011 and 2010 these ratios were as follows:

	31 December 2011, %	31 December 2010, %
Instant Liquidity Ratio (30% is the minimum required by CBA) (assets receivable or realisable within one day/liabilities repayable on demand)	125	171

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2011 and 2010 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 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

Financial liabilities As at 31 December 2010	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	98	7,641	16,628	485	24,852
Amounts due to customers	254,282	67,249	26,362	-	347,893
Amounts due to credit institutions	1,395	5,553	-	-	6,948
Other financial liabilities	149	1,120	-	-	1,269
Total undiscounted financial liabilities	255,924	81,563	42,990	485	380,962

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 2011	31,648	19,844	5,151	-	56,643
As of 31 December 2010	12,036	20,859	4,194	-	37,089

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 2010. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2010 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 financial position and 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 CBA.

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

Financial assets	AZN	USD	EUR	OTHER	Total 2011
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	AZN	USD	EUR	OTHER	Total 2011
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

As at 31 December 2010 the Bank had the following exposure to foreign currency exchange rate risk:

Financial assets	AZN	USD	EUR	OTHER	Total 2010
Cash and cash equivalents	83,216	38,586	10,946	144	132,892
Trading securities	-	439	402	56	897
Securities purchased under agreements to resell	5,775	-	-	-	5,775
Amounts due from credit institutions	7,031	1,551	14,094	-	22,676
Investment securities available–for–sale	149,400	-	-	-	149,400
Investment securities held to maturity	304	202	-	-	506
Loans to banks	3,901	478	-	-	4,379
Loans to customers	161,668	15,788	10,412	-	187,868
Other financial assets	24	69	62	4	159
Total financial assets	411,319	57,113	35,916	204	504,552

Financial liabilities	AZN	USD	EUR	OTHER	Total 2010
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	24,004	3	-	-	24,007
Amounts due to customers	273,782	34,438	30,350	29	338,599
Amounts due to credit institutions	-	1,330	5,456	-	6,786
Other financial liabilities	1,228	10	31	-	1,269
Total financial liabilities	299,014	35,781	35,837	29	370,661
Net financial position	112,305	21,332	79	175	133,891

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 externalloans as well asloans to foreign operations within the Bank where the denomination of theloan is in a currency other than the currency of thelender or the borrower.

Impact on profit before tax based on assets value as at 31 December 2011 and 2010:

	31 December 2011		31 December 2010	
	AZN/USD +10%	AZN/USD -10%	AZN/USD +10%	AZN/USD -10%
Impact on profit before tax	40	(40)	(2,133)	2,133

	31 December 2011		31 December 2010	
	AZN/EUR +10%	AZN/EUR -10%	AZN/EUR +10%	AZN/EUR -10%
Impact on profit before tax	40	(40)	(2,133)	2,133

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

At 31 December 2010 Financial assets	Level 1	Level 2	Level 3	Total
Trading securities	897	-	-	897
Investment securities available–for–sale	149,400	-	-	149,400
	150,297	-	-	150,297

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

Financial assets	Carrying value 2011	Fair value 2011	Unrecognized gain/(loss) 2011	Carrying value 2010	Fair value 2010	Unrecognized gain/(loss) 2010
Cash and cash equivalents	35,105	35,105	-	132,892	132,892	-
Amounts due from credit institutions	24,684	24,684	-	22,676	22,676	-
Investment securities held to maturity	-	-	-	506	506	-
Loans to banks	1,500	1,500	-	4,379	4,379	-
Loans to customers	234,004	234,004	-	187,868	187,868	-
Investment property	2,000	1,920	(80)	-	-	-
Financial liabilities						
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	30,896	30,896	-	24,007	24,007	-
Amounts due to customers	371,499	371,499	-	338,599	338,599	-
Amounts due to credit institutions	14,107	14,107	-	6,786	6,786	-
Total unrecognised change in unrealised fair value			(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.

Note 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 2011			31 December 2010		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Cash and cash equivalents	35,105	-	35,105	132,892	-	132,892
Trading securities	24,736	-	24,736	897	-	897
Securities purchased under agreements to resell	26,932	-	26,932	5,775	-	5,775
Amounts due from credit institutions	24,684	-	24,684	22,437	239	22,676
Investment securities available–for–sale	46,419	162,888	209,307	111,757	37,643	149,400
Investment securities held to maturity	-	-	-	209	297	506
Loans to banks	1,500	-	1,500	2,379	2,000	4,379
Loans to customers	131,657	102,347	234,004	59,540	128,328	187,868
Property and equipment	-	4,216	4,216	-	3,549	3,549
Investment property	-	2,000	2,000	-	-	-
Intangible assets	-	1,842	1,842	-	1,607	1,607
Current income tax assets	112	-	112	-	-	-
Other assets	6,975	2,467	9,442	2,755	-	2,755
Total assets	298,120	275,760	573,880	338,641	173,663	512,304
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	12,812	18,084	30,896	7,002	17,005	24,007
Amounts due to customers	349,005	22,494	371,499	315,779	22,820	338,599
Amounts due to credit institutions	14,107	-	14,107	6,786	-	6,786
Current income tax liabilities	-	-	-	573	-	573
Deferred income tax liabilities	758	-	758	-	-	-
Provision for guarantees and other commitments	1,404	-	1,404	1,582	-	1,582
Other liabilities	3,343	45	3,388	3,942	-	3,942
Amount reserved for increase in share capital	2,645	-	2,645	-	-	-
Total liabilities	384,074	40,623	424,697	335,664	39,825	375,489
Net	(85,954)	235,137	149,183	2,977	133,838	136,815

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 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.

Note 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 2011					31 December 2010				
	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	-	21,327	236	-	21,563	-	2,350	113	-	2,463
Loans issued during the year	16	1,724	547	-	2,287	-	21,371	528	-	21,899
Loan repayments during the year	-	(1,147)	(484)	-	(1,631)	-	(2,479)	(407)	-	(2,886)
Interest accrual	-	85	5	-	90	-	85	2	-	87
Loans outstanding at 31 December, gross	16	21,989	304	-	22,309	-	21,327	236	-	21,563
Less: allowance for impairment at 31 December	-	(192)	(5)	-	(197)	-	(102)	(1)	-	(103)
Loans outstanding at 31 December, net	16	21,797	299	-	22,112	-	21,225	235	-	21,460
Interest income on loans	1	2,548	27	-	2,576	-	1,768	36	-	1,804
Deposits at 1 January	52,701	6,800	301	50,691	110,493	14,310	100	317	37,881	52,608
Deposits received during the year	40,200	13,800	76	78,681	132,757	52,523	6,800	303	77,564	137,190
Deposits repaid during the year	(45,341)	(13,600)	(2)	(66,779)	(125,722)	(14,132)	(100)	(319)	(64,754)	(79,305)
Deposits at 31 December	47,560	7,000	375	62,593	117,528	52,701	6,800	301	50,691	110,493
Current accounts at 31 December	5,339	61,162	77	84,363	150,941	16,010	49,408	31	30,262	95,711
Interest expense on deposits	(3,802)	(471)	(28)	(2,732)	(7,033)	(1,988)	(60)	(27)	(3,497)	(5,572)
Guarantees issued	-	32	-	-	32	-	6,152	-	-	6,152
Letters of credit issued	-	-	-	-	-	-	948	-	-	948
Unused credit lines	75	340	100	15	530	-	321	-	-	321
Fee and commission income	21	756	1	60	838	31	531	4	-	566
Other operating expenses	-	(413)	-	(70)	(483)	-	(30)	-	(70)	(100)

	Year ended 31 December 2011	Year ended 31 December 2010
Salaries and other benefits	(1,455)	(1,222)
Social security costs	(320)	(269)
Total key management compensation	(1,775)	(1,491)

Note 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 CBA and the Basel Capital Accord 1988 in supervising the Bank.

During the past year, the Bank had complied in full with all it's 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.

CBA capital adequacy ratio

The CBA requires banks to maintain a minimum capital adequacy ratio of 12% of risk-weighted assets. As of 31 December 2011 and 2010 the Bank's capital adequacy ratio on this basis was as follows:

	31 December 2011	31 December 2010
Tier 1 capital	131,301	124,216
Tier 2 capital	15,944	11,436
Less: Deductions from capital	(1,841)	(1,607)
Total regulatory capital	145,404	134,045
Risk-weighted assets	337,840	269,457
Capital adequacy ratio	43%	50%

The Bank's capital adequacy ratio, computed in accordance with the Basel Capital Accord 1988 (which recommends a minimum capital adequacy ratio of 8% for Tier 1 and Total regulatory capital), with subsequent amendments including the amendment to incorporate market risks, as of 31 December 2011 and 2010, comprised:

	31 December 2011	31 December 2010
Tier 1 capital	149,192	136,815
Tier 2 capital	(9)	-
Total regulatory capital	149,183	136,815
Risk-weighted assets	294,523	222,371
Tier 1 capital adequacy ratio	51%	62%
Total capital adequacy ratio	51%	62%