OJSC PASHA Bank
Consolidated financial statements

Year ended 31 December 2013
together with independent auditors' report

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Building a better working world

Ernst & Young Holdings (CIS) B.V.
Port Baku Towers Business Centre
South Tower, 9th floor
153, Neftchilar Ave.
Baku, AZ1010, Azerbaijan
Tel: +994 (12) 490 7020
Fax: +994 (12) 490 7017
www.ey.com/az

Ernst & Yanq Holdinqs (SiAyEs) Bi.Vi.
Port Baku Tauers Biznes Mərkəzi
Cənub Qülləsi, 9-cu mərtəbə
Neftçilər prospekti, 153
Bakı, AZ1010, Azərbaycan
Tel: +994 (12) 490 7020
Faks: +994 (12) 490 7017

Independent auditors' report

To the Shareholders and Board of Directors of OJSC PASHA Bank

We have audited the accompanying consolidated financial statements of OJSC PASHA Bank and its subsidiary, which comprise the consolidated statement of financial position as at 31 December 2013, and the consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year 2013, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of OJSC PASHA Bank and its subsidiary as at 31 December 2013, and their financial performance and cash flows for the year 2013 in accordance with International Financial Reporting Standards.

Ernst & Young Holdings (CIS) B.V.

28 March 2014

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2013

(Figures in Tables are in thousands of Azerbaijani manats)

	Notes	*31 December 2013*	*31 December 2012*
Assets			
Cash and cash equivalents	5	48,056	68,526
Trading securities	6	51,717	14,180
Amounts due from credit institutions	7	32,639	14,960
Investment securities available-for-sale	8	156,126	323,699
Loans to banks	9	14,107	1,000
Loans to customers	10	329,218	274,141
Investment property	11	2,000	2,000
Property and equipment	12	14,389	8,900
Intangible assets	13	3,989	2,278
Prepayment for equity investment	14	41,971	–
Other assets	15	9,843	11,391
Total assets		**704,055**	**721,075**
Liabilities			
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	16	107,286	35,045
Amounts due to customers	17	302,817	457,067
Amounts due to credit institutions	18	37,252	30,935
Current income tax liabilities		1,562	484
Deferred income tax liabilities	19	1,969	2,327
Provision for guarantees and letters of credit	22	150	967
Dividends payable to shareholders	20	14,992	–
Other liabilities	15	3,104	5,902
Total liabilities		**469,132**	**532,727**
Equity			
Share capital	20	228,000	157,000
Retained earnings		7,699	31,178
Net unrealised (losses)/gains on investment securities available-for-sale		(44)	181
Foreign currency translation reserve		(732)	(11)
Total equity		**234,923**	**188,348**
Total liabilities and equity		**704,055**	**721,075**

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

28 March 2014

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

The accompanying notes on pages 6 to 47 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

For the year ended 31 December 2013

(Figures in Tables are in thousands of Azerbaijani manats)

	Notes	*Year ended 31 December 2013*	*Year ended 31 December 2012*
Interest income			
Loans to customers		38,792	34,503
Investment securities available-for-sale		11,300	9,626
Amounts due from credit institutions		1,715	2,100
Trading securities		2,621	1,428
Loans to banks		281	352
Securities purchased under agreements to resell		63	132
		54,772	**48,141**
Interest expense			
Amounts due to customers		(8,682)	(11,416)
Amounts due to credit institutions		(2,387)	(1,213)
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds		(1,292)	(1,653)
		(12,361)	**(14,282)**
Net interest income		**42,411**	**33,859**
Provision for impairment of interest earning assets	22	(13,715)	(7,338)
Net interest income after provision for impairment of interest bearing assets		**28,696**	**26,521**
Net fee and commission income	23	3,038	3,543
Net gains from trading securities		417	720
Net gains/(losses) from investment securities available-for-sale		174	(63)
Net gains/(losses) from foreign currencies:			
- dealing		5,562	4,485
- translation differences		(127)	563
Other income		108	35
Non-interest income		**9,172**	**9,283**
Personnel expenses	24	(10,901)	(7,438)
General and administrative expenses	24	(9,095)	(6,731)
Depreciation and amortisation	12,13	(2,570)	(1,310)
Reversal of provision for guarantees and letters of credit	22	817	437
Non-interest expenses		**(21,749)**	**(15,042)**
Profit before income tax expense		**16,119**	**20,762**
Income tax expense	19	(4,091)	(4,551)
Net profit for the year		**12,028**	**16,211**

The accompanying notes on pages 6 to 47 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2013

(Figures in Tables are in thousands of Azerbaijani manats)

	Notes	*Year ended 31 December 2013*	*Year ended 31 December 2012*
Net profit for the year		**12,028**	**16,211**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods:			
Gross unrealised (losses)/gains on investment securities available-for-sale		(107)	174
Realised (gains)/losses on investment securities available-for-sale reclassified to the consolidated statement of profit or loss		(174)	63
Net unrealised (losses)/gains on investment securities available-for-sale	**20**	**(281)**	**237**
Tax effect of net losses/(gains) on investment securities available-for-sale	19	56	(47)
Foreign currency translation difference net of tax	20	(721)	(11)
Net other comprehensive income to be reclassified to profit or loss in subsequent periods		**(946)**	**179**
Total comprehensive income for the year		**11,082**	**16,390**

The accompanying notes on pages 6 to 47 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2013

(Figures in Tables are in thousands of Azerbaijani manats)

	Share capital	*Retained earnings*	*Net unrealized (losses)/gains on investment securities available-for-sale*	*Foreign currency translation reserve*	*Total equity*
31 December 2011	**123,475**	**25,717**	**(9)**	**–**	**149,183**
Net profit for the year	–	16,211	–	–	16,211
Other comprehensive income for the year	–	–	190	(11)	179
Total comprehensive income for the year	**–**	**16,211**	**190**	**(11)**	**16,390**
Capitalization of net profit for the year 2011 to share capital (Note 20)	10,750	(10,750)	–	–	–
Capitalization of amount reserved for increase in share capital (Note 20)	2,645	–	–	–	**2,645**
Cash contribution for share capital increase (Note 20)	20,130	–	–	–	**20,130**
31 December 2012	**157,000**	**31,178**	**181**	**(11)**	**188,348**
Net profit for the year	–	12,028	–	–	12,028
Other comprehensive income for the year	–	–	(225)	(721)	(946)
Total comprehensive income for the year	**–**	**12,028**	**(225)**	**(721)**	**11,082**
Dividends declared (Note 20)	–	(35,507)	–	–	**(35,507)**
Cash contribution for share capital increase (Note 20)	71,000	–	–	–	**71,000**
31 December 2013	**228,000**	**7,699**	**(44)**	**(732)**	**234,923**

The accompanying notes on pages 6 to 47 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2013

(Figures in Tables are in thousands of Azerbaijani manats)

	Notes	*Year ended 31 December 2013*	*Year ended 31 December 2012*
Cash flows from operating activities			
Interest received		51,726	45,257
Interest paid		(12,552)	(13,786)
Fees and commissions received		5,963	4,991
Fees and commissions paid		(2,973)	(1,846)
Net realized gain on sale of investment securities available-for-sale		174	–
Net realized gains from trading securities		118	540
Realised gains less losses from dealing in foreign currencies		5,562	4,485
Personnel expenses paid		(10,297)	(6,973)
General and administrative expenses paid		(11,488)	(6,373)
Other operating income received		63	26
Cash flows from operating activities before changes in operating assets and liabilities		**26,296**	**26,321**
Net (increase)/decrease in operating assets			
Trading securities		(36,837)	10,822
Amounts due from credit institutions		(18,074)	9,801
Loans to banks		(13,051)	500
Loans to customers		(67,479)	(46,182)
Other assets		(1,185)	(2,469)
Net increase/(decrease) in operating liabilities			
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds		72,582	3,923
Amounts due to customers		(153,024)	86,055
Amounts due to credit institutions		6,803	16,466
Other liabilities		(62)	1,713
Net cash (used in) / from operating activities before income tax		**(184,031)**	**106,950**
Income tax paid		(2,634)	(1,374)
Net cash (used in) / from operating activities	-	**(186,665)**	**105,576**
Cash flows from investing activities			
Proceed from sale of securities purchased under agreements to resell		–	26,931
Purchase of investment securities available-for-sale		(259,275)	(584,590)
Proceeds from sale and redemption of investment securities available-for-sale		425,386	471,741
Purchase and prepayments for property and equipment		(6,009)	(4,367)
Acquisition of intangible assets		(1,943)	(723)
Proceeds from sale of property and equipment		47	9
Prepayment for equity investment	14	(41,971)	–
Net cash from / (used in) investing activities		**116,235**	**(90,999)**
Cash flows from financing activities			
Share capital contribution	20	71,000	20,130
Dividends paid	20	(20,515)	(982)
Net cash from financing activities		**50,485**	**19,148**
Effect of exchange rates changes on cash and cash equivalents		(525)	(304)
Net (decrease)/increase in cash and cash equivalents		**(20,470)**	**33,421**
Cash and cash equivalents, beginning	5	**68,526**	**35,105**
Cash and cash equivalents, ending	5	**48,056**	**68,526**

The accompanying notes on pages 6 to 47 are an integral part of these consolidated financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

1. Principal activities

OJSC PASHA Bank (the "Bank") was formed on 18 June 2007 as an open joint stock company under the laws of the Republic of Azerbaijan. The Bank operates under a banking licence number 250 issued by the Central Bank of the Republic of Azerbaijan (the "CBAR") on 28 November 2007.

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

The Bank has four service points in Azerbaijan as at 31 December 2013 (31 December 2012: three), one representative office and one subsidiary, JSC PASHA Bank Georgia (the "Subsidiary") located in the Republic of Georgia.

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

On 17 December 2012, the Bank established JSC PASHA Bank Georgia, a wholly – owned subsidiary, which operates in the banking sector, with registered and paid up share capital of GEL 35,000 thousands or AZN 16,615 thousands. On 17 January 2013 JSC PASHA Bank Georgia received a license for banking activities issued by the National Bank of Georgia ("NBG").

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

As at 31 December 2013 and 31 December 2012 the following shareholders owned the outstanding shares of the Bank:

Shareholders	*31 December 2013 (%)*	*31 December 2012 (%)*
Pasha Holding Ltd.	60	60
Ador Ltd.	30	30
Mr. Arif Pashayev	10	10
Total	**100**	**100**

As at 31 December 2013, the Bank is ultimately owned by Mrs. Leyla Aliyeva and Mrs. Arzu Aliyeva, who exercise joint control over the Bank.

2. Basis of preparation

General

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

The Azerbaijani manat is the functional and presentation currency of OJSC PASHA Bank as the majority of the transactions are denominated, measured, or funded in Azerbaijani manat. Transactions in other currencies are treated as transactions in foreign currencies. The Bank is required to maintain its records and prepare its financial statements in Azerbaijani manat and in accordance with IFRS. These consolidated financial statements are presented in thousands of Azerbaijani manat ("AZN"), except when otherwise indicated. The consolidated financial statements have been prepared under the historical cost convention except for trading and available for sale securities which have been measured at fair value.

Basis for consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiary for the year ended 31 December 2013. The financial statements of Pasha Bank's subsidiary are prepared for the same reporting year as Pasha Bank, using consistent accounting policies.

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies

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:

IFRS 10 Consolidated Financial Statements and IAS 27 Separate Financial Statements
IFRS 10 establishes a single control model that applies to all entities including special purpose entities. IFRS 10 replaces the parts of previously existing IAS 27 *Consolidated and Separate Financial Statements* that dealt with consolidated financial statements and SIC-12 *Consolidation – Special Purpose Entities*. IFRS 10 changes the definition of control such that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. To meet the definition of control in IFRS 10, all three criteria must be met, including: (a) an investor has power over an investee; (b) the investor has exposure, or rights, to variable returns from its involvement with the investee; and (c) the investor has the ability to use its power over the investee to affect the amount of the investor's returns. IFRS 10 had no impact on the consolidation of investments held by the Bank.

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. The application of IFRS 13 has not materially impacted the fair value measurements carried out by the Bank. IFRS 13 also requires specific disclosures on fair values, some of which replace existing disclosure requirements in other standards, including IFRS 7 *Financial Instruments: Disclosures*. Some of these disclosures are specifically required for financial instruments by IAS 34.16A(j), thereby affecting the consolidated financial statements. The Bank provides these disclosures in Note 26.

Amendments to IAS 19 Employee Benefits
The IASB has published amendments to IAS 19 *Employee Benefits*, effective for annual periods beginning on or after 1 January 2013, which involve major changes to the accounting for employee benefits, including the removal of the option for deferred recognition of changes in pension plan assets and liabilities (known as the "corridor approach"). In addition, these amendments will limit the changes in the net pension asset (liability) recognised in profit or loss to net interest income (expense) and service costs. These amendments had 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 change the grouping of items presented in other comprehensive income. Items that could be reclassified (or recycled) to profit or loss at a future point in time (for example, net losses or gains on available-for-sale financial assets) would be presented separately from items that will never be reclassified (for example, revaluation of buildings). The amendment affects presentation only and has no impact on the Bank's financial position or performance.

Amendments to IFRS 7 Disclosures – Offsetting Financial assets and Financial Liabilities
These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognized financial instruments that are set off in accordance with IAS 32 *Financial Instruments: Presentation*. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreements, irrespective of whether they are set off in accordance with IAS 32. These amendments had no impact on the Banks' financial position or performance.

Fair value measurement

The Bank measures financial instruments, such as trading and available-for-sale securities, derivatives and non-financial assets such as investment property, at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortised cost are disclosed in Note 26.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Fair value measurement (continued)

The principal or the most advantageous market must be accessible by the Bank. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 – Quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- Level 2 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;
- Level 3 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the consolidated financial statements on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

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. 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 market place.

Financial assets at fair value through profit or loss

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

Held to maturity investments

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Financial assets (continued)

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

The Bank places deposits with banks as well as issues loans to banks. According to the terms of deposit agreements the Bank is allowed to withdraw deposits before maturity while as per terms of loan agreements the Bank is not allowed to do so and loans can be demanded by the Bank at maturity.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition available-for-sale financial assets are measured at fair value with gains or losses being recognized in other comprehensive income until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to the consolidated statement of profit or loss. However, interest calculated using the effective interest method is recognized in profit or loss.

Offsetting

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

Reclassification of financial assets

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

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

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

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

Cash and cash equivalents

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

3. Summary of significant accounting policies (continued)

Repurchase and reverse repurchase agreements

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the consolidated statement of financial position and, in case the transferee has the right by contract or custom to sell or re-pledge them, reclassified as securities pledged under sale and repurchase agreements. The corresponding liability is presented within amounts due to credit institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as separate account on the consolidated statement of financial position if material or as cash and cash equivalents or loans to customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

Borrowings

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

Leases

Operating – Bank as lessee

Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognised as expenses on a straight-line basis over the lease term and included into other operating expenses.

Measurement of financial instruments at initial recognition

When financial instruments are recognised initially, they are measured at fair value, adjusted, in the case of instruments not at fair value through profit or loss, for directly attributable fees and costs.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Bank determines that the fair value at initial recognition differs from the transaction price, then:

- if the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets, the Bank recognises the difference between the fair value at initial recognition and the transaction price as a gain or loss;
- in all other cases, the initial measurement of the financial instrument is adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the Bank recognises that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Impairment of financial assets (continued)

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

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

If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

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

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 consolidated statement of profit or loss. Impairment losses on equity investments are not reversed through the consolidated statement of profit or loss; increases in their fair value after impairment are recognized in other comprehensive income.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Impairment of financial assets (continued)

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

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

Held to maturity financial investments

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

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

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.

The accounting treatment of such restructuring is as follows:

- If the currency of the loan has been changed the old loan is derecognised and the new loan is recognised.
  - If the loan restructuring is not caused by the financial difficulties of the borrower the Bank uses the same approach as for financial liabilities described below.
  - If the loan restructuring is due to the financial difficulties of the borrower and the loan is impaired after restructuring, the Bank recognizes the difference between the present value of the new cash flows discounted using the original effective interest rate and the carrying amount before restructuring in the provision charges for the period. In case loan is not impaired after restructuring the Bank recalculates the effective interest rate.
  - 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 or current 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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

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

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

Financial liabilities

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

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

Financial guarantees

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

Any increase in the liability relating to financial guarantees is taken to current year profit. The premium received is recognized in profit or loss 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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Property and equipment

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

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

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

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

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

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

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

Investment property

Investment property is land or building or a part of building held to earn rental income or for capital appreciation and which is not used by the Bank or held for the sale in the ordinary course of business. Property that is being constructed or developed or redeveloped for future use as investment property is also classified as investment property.

Investment property is initially recognized at cost, including transaction costs, and subsequently is stated at cost less accumulated depreciation and any accumulated impairment losses. For disclosure purposes investment property is re-measured at fair value reflecting market conditions at the end of the reporting period. Fair value of the Bank's investment property is determined on the base of various sources including reports of independent appraisers, who hold a recognized and relevant professional qualification and who have recent experience in valuation of property of similar location and category.

Earned rental income is recorded in the income statement within income arising from non-banking activities. Gains and losses resulting from changes in the fair value of investment property are recorded in the consolidated statement of profit or loss and presented within income or expense arising from non-banking activities.

Subsequent expenditure is capitalized only when it is probable that future economic benefits associated with it will flow to the Bank and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred. If an investment property becomes owner-occupied, it is reclassified to premises and equipment, and its carrying amount at the date of reclassification becomes its deemed cost.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Intangible assets

Intangible assets consist of licenses and computer software.

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

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

Provisions

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

Retirement and other employee benefit obligations

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

Share capital

Share capital

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

Dividends

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

Contingencies

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

Recognition of income and expenses

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Recognition of income and expenses (continued)

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 documentary operations (letters of credit and guarantees), customer, brokerage, custodian and foreign currency purchase/sale fees.

Foreign currency translation

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

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

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

The Bank used the following official exchange rates at 31 December 2013 and 2012 in the preparation of these consolidated financial statements:

	31 December 2013	*31 December 2012*
1 US Dollar	AZN 0.7845	AZN 0.7850
1 Euro	AZN 1.0780	AZN 1.0377
1 Georgian Lari	AZN 0.4521	AZN 0.4744

3. Summary of significant accounting policies (continued)

Standards and interpretations issued but not yet effective

IFRS 9 Financial Instruments
IFRS 9, as issued, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but Amendments to IFRS 9 *Mandatory Effective Date of IFRS 9 and Transition Disclosures*, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the IASB is addressing hedge accounting and impairment of financial assets. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Bank's financial assets, but will not have an impact on classification and measurements of the Bank's financial liabilities. The Bank will quantify the effect in conjunction with the other phases, when the final standard including all phases is issued.

Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)
These amendments are effective for annual periods beginning on or after 1 January 2014 provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. It is not expected that this amendment would be relevant to the Bank, since none of the entities in the Bank does not qualify to be an investment entity under IFRS 10.

IAS 32 Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32
These amendments clarify the meaning of "currently has a legally enforceable right to set-off" and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting. These are effective for annual periods beginning on or after 1 January 2014. These amendments are not expected to be relevant to the Bank.

IFRIC Interpretation 21 Levies (IFRIC 21)
IFRIC 21 clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. IFRIC 21 is effective for annual periods beginning on or after 1 January 2014. The Bank does not expect that IFRIC 21 will have a material impact on its financial statements.

IAS 39 Novation of Derivatives and Continuation of Hedge Accounting – Amendments to IAS 39
These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. These amendments are effective for annual periods beginning on or after 1 January 2014. The Bank has not novated its derivatives during the current period. However, these amendments would be considered for future novations.

4. Significant accounting judgments and estimates

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

Fair value of financial instruments

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

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management interpretation of such legislation and changes, including the law allowing financial institutions to be exempt from payment of profit tax starting 1 January 2009 (for 3 consequent years) if the current year profit is capitalized, as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. As such, additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three years including the year of review. Management believes that as at 31 December 2013 its interpretation of the relevant legislation is appropriate and that the Bank's tax position will be sustained.

(Figures in tables are in thousands of Azerbaijani manats)

4. Significant accounting judgments and estimates (continued)

Allowance for loan impairment

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

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

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

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	31 December 2013	*31 December 2012*
Cash on hand	11,768	12,948
Current accounts with the CBAR and NBG	7,968	32,978
Current accounts with other credit institutions	10,195	22,600
Time deposits with credit institutions up to 90 days	18,125	–
Cash and cash equivalents	**48,056**	**68,526**

Current accounts with other credit institutions consist of interest bearing correspondent account balances with one resident bank and two non–resident banks the amount of AZN 6,854 thousands (31 December 2012 – AZN 3,937 thousands) and non-interest bearing correspondent account balances with resident and non-resident banks in the amount of AZN 619 thousands (31 December 2012 – AZN 163 thousands) and AZN 2,722 thousands (31 December 2012 – AZN 18,500 thousands), respectively.

As at 31 December 2013, the Bank placed AZN 18,125 thousands in time deposits with one resident bank and one non-resident bank maturing through January 2014 and with annual interest rate of 0.10%-11.50% p.a (31 December 2012 – nil).

(Figures in tables are in thousands of Azerbaijani manats)

6. Trading securities

Trading securities comprise:

	31 December 2013		*31 December 2012*	
	Annual interest rate	*Carrying value*	*Annual interest rate*	*Carrying value*
Corporate bonds issued by Unibank Commercial Bank OJSC	11.00%-14.00%	15,796	11.00%	2,155
Corporate bonds issued by Bakcell LTD	9.50%	14,534	9.50%	3,506
Corporate bonds issued by FINCA Azerbaijan limited liability non-banking credit organization	11.50%	6,431	–	–
Corporate bonds issued by AccessBank CJSC	9.00%	6,425	–	–
Corporate bonds issued by Bank of Baku OJSC	12.00%	4,533	12.00%	3,604
Corporate bonds issued by "Unileasing" Leasing Company CJSC	10.50%	2,047	9.50%	4,915
Corporate bonds issued by AGBank Commercial Bank OJSC	12.00%	1,951	–	–
Trading securities		**51,717**		**14,180**

As at 31 December 2013, the Bank carried market maker service activities and signed related agreements with seven (2012 – four) local entities. As at 31 December 2013, the Bank had trading securities under these agreements amounting to AZN 51,717 thousands (2012 – AZN 14,180 thousands).

7. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	31 December 2013	*31 December 2012*
Time deposits	21,861	3,690
Obligatory reserve with the CBAR and NBG	10,778	11,270
Amounts due from credit institutions	**32,639**	**14,960**

As at 31 December 2013, AZN 14,683 thousands or 67% of total time deposits (2012 – AZN 3,225 thousands or 87% of total time deposits) was placed on inter-bank deposits with two local (2012 – two local) commercial banks maturing through 04 June 2014 (2012 – through 12 April 2013) and with effective annual interest rate of 3%-10% (2012 – 9%-12%).

Credit institutions in the Republic of Azerbaijan and Republic of Georgia are required to maintain a non-interest earning cash deposit as obligatory reserve with the CBAR at 3% p.a. and interest earning cash deposit with NBG at 10% p.a. and at 15% p.a. (31 December 2012 – the CBAR at 3% p.a. and NBG at 10% p.a. and 15% p.a.) of the previous month (as per the CBAR) and for the appropriate two-week period (as per NBG) average of funds attracted from customers by the credit institution in local and foreign currencies, respectively. The Bank's ability to withdraw such deposit is restricted by statutory legislation.

(Figures in tables are in thousands of Azerbaijani manats)

8. Investment securities available-for-sale

Investment securities available-for-sale comprise:

	31 December 2013		*31 December 2012*	
	Carrying value	*Nominal value*	*Carrying value*	*Nominal value*
Notes issued by the Azerbaijan Mortgage Fund	125,243	123,925	181,988	179,267
Notes issued by Baghlan Group FZCO	20,605	19,934	36,320	35,325
Certificates of Deposit of National Bank of Georgia	5,525	5,564	–	–
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	4,086	4,000	77,311	76,680
Corporate bonds issued by FinansLizinq Open Joint Stock Company (OJSC)	414	400	–	–
Corporate bonds issued by TBC Kredit	253	250	–	–
Notes issued by the Central Bank of the Republic of Azerbaijan	–	–	28,080	28,104
Investment securities available-for-sale	**156,126**	**154,073**	**323,699**	**319,376**

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

	31 December 2013		*31 December 2012*	
	%	*Maturity*	*%*	*Maturity*
Notes issued by Azerbaijan Mortgage Fund	3.00%-3.25%	May 2016 – January 2022	3.00%-3.25%	May 2016 – November 2022
Notes issued by Baghlan Group FZCO	14.75%	June 2015	14.75%	June 2015
Certificates of Deposit of National Bank of Georgia	3.80%-4.25%	January-June 2014	–	–
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	4.25%-5.00%	July 2015 – July 2016	4.00%-5.00%	June 2013 – July 2015
Corporate bonds issued by FinansLizinq Open Joint Stock Company (OJSC)	14.00%	January 2015	–	–
Corporate bonds issued by TBC Kredit	7.00%	April 2014	–	–
Notes issued by the Central Bank of the Republic of Azerbaijan	–	–	1.66%-2.65%	January 2013

9. Loans to banks

As at 31 December 2013, the Bank had outstanding amount of AZN 14,107 thousands (2012 – AZN 1,000 thousands) of unsecured loans denominated in Azerbaijani manat, issued to four resident commercial banks (2012 – one resident commercial bank) with contractual maturity through June 2014 (2012 – February 2013) and annual interest rate of 8%-12% (2012 – 10.50%).

10. Loans to customers

Loans to customers comprise:

	31 December 2013	*31 December 2012*
Legal entities	328,939	262,616
Individuals	22,017	20,221
Loans to customers (gross)	**350,956**	**282,837**
Less – allowance for impairment (Note 22)	(21,738)	(8,696)
Loans to customers (net)	**329,218**	**274,141**

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

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

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

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

Loans are made in the following industry sectors:

	31 December 2013	*31 December 2012*
Trade and services	141,025	130,646
Manufacturing	87,922	62,611
Construction	38,280	34,960
Individuals	22,017	20,221
Agriculture and food processing	21,933	15,862
Non banking credit organizations	13,018	474
Transport and telecommunication	12,946	12,698
Mining	12,844	–
Leasing	744	5,014
Energy	171	312
Other	56	39
Total loans (gross)	**350,956**	**282,837**

As at 31 December 2013, the Bank granted loans to 7 customers (2012 – 6 customers) totalling AZN 148,419 thousands (2012 – AZN 104,683 thousands), which individually exceeded 5% of the Bank's equity.

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2013, comprised AZN 3,466 thousands (2012 – AZN 3,212 thousands).

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

The main types of collateral obtained are as follows:

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

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

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.

11. Investment property

During 2011, the Bank acquired land for the amount of AZN 2,000 thousands as investment property which is held for long-term appreciation in value. As at 31 December 2013 the fair value of this investment property amounted to AZN 2,074 thousands (2012 – AZN 1,997 thousands).

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 improve-ments*	*Construc-tion in progress*	*Total*
Cost								
31 December 2011	**2,151**	**1,521**	**1,191**	**926**	**35**	**108**	**–**	**5,932**
Additions	–	1,799	683	87	258	573	2,307	5,707
Disposals	–	(3)	–	(21)	–	–	–	(24)
Transfers	2,307	148	(148)	–	–	–	(2,307)	–
31 December 2012	**4,458**	**3,465**	**1,726**	**992**	**293**	**681**	**–**	**11,615**
Additions	2,316	1,681	2,370	226	206	868	–	7,667
Disposals	–	(11)	(15)	(98)	(28)	–	–	(152)
31 December 2013	**6,774**	**5,135**	**4,081**	**1,120**	**471**	**1,549**	**–**	**19,130**
Accumulated depreciation								
31 December 2011	**–**	**(709)**	**(635)**	**(312)**	**(21)**	**(39)**	**–**	**(1,716)**
Depreciation charge	(120)	(376)	(255)	(211)	(22)	(39)	–	(1,023)
Disposals	–	3	–	21	–	–	–	24
31 December 2012	**(120)**	**(1,082)**	**(890)**	**(502)**	**(43)**	**(78)**	**–**	**(2,715)**
Depreciation charge	(206)	(844)	(544)	(233)	(82)	(238)	–	(2,147)
Disposals	–	6	2	98	15	–	–	121
31 December 2013	**(326)**	**(1,920)**	**(1,432)**	**(637)**	**(110)**	**(316)**	**–**	**(4,741)**
Net book value								
31 December 2013	**6,448**	**3,215**	**2,649**	**483**	**361**	**1,233**	**–**	**14,389**
31 December 2012	**4,338**	**2,383**	**836**	**490**	**250**	**603**	**–**	**8,900**
31 December 2011	**2,151**	**812**	**556**	**614**	**14**	**69**	**–**	**4,216**

(Figures in tables are in thousands of Azerbaijani manats)

13. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Total*
Cost			
31 December 2011	**400**	**1,846**	**2,246**
Additions	404	319	723
Disposals	(32)	–	(32)
31 December 2012	772	**2,165**	**2,937**
Additions	1,607	527	2,134
Disposals	(42)	–	(42)
31 December 2013	**2,337**	**2,692**	**5,029**
Accumulated amortization			
31 December 2011	**(131)**	(273)	(404)
Amortisation charge	(25)	(262)	(287)
Disposals	32	–	32
31 December 2012	**(124)**	**(535)**	**(659)**
Amortisation charge	(175)	(248)	(423)
Disposals	42	–	42
31 December 2013	**(257)**	**(783)**	**(1,040)**
Net book value			
31 December 2013	**2,080**	**1,909**	**3,989**
31 December 2012	**648**	**1,630**	**2,278**
31 December 2011	**269**	**1,573**	**1,842**

14. Prepayment for equity investment

In July 2013, the Bank has resolved to make an investment and acquire a target bank registered under the legislation of a foreign country, which shall become the Bank's subsidiary upon completion of the acquisition process. The Bank made a prepayment for this equity investment in the amount of AZN 41,971 thousands under Share Sale and Purchase agreement. The acquisition is expected to be completed in the second half of 2014.

15. Other assets and liabilities

Other assets comprise:

	31 December 2013	*31 December 2012*
Other financial assets		
Settlements on money transfers	673	123
Accrued interest receivable on guarantees and letters of credit	176	119
	849	**242**
Other non-financial assets		
Deferred expenses	5,137	5,911
Prepayments for acquisition of property, equipment and intangible assets	3,029	4,878
Other	828	360
	8,994	**11,149**
Other assets	**9,843**	**11,391**

As at 31 December 2013, deferred expenses of AZN 4,078 thousands (2012 – AZN 5,161 thousands), related to prepayment for the rent of the service point located in Baku.

As at 31 December 2013, prepayments for the purchase of property, equipment and intangible assets of AZN 3,029 thousands (2012 – AZN 4,878 thousands) were related to premises for the Bank's new service points.

(Figures in tables are in thousands of Azerbaijani manats)

15. Other assets and liabilities (continued)

Other liabilities comprise:

	31 December 2013	*31 December 2012*
Other financial liabilities		
Payables for construction works of branches in regions	346	–
Settlements on money transfer	252	372
Accrued expenses	106	3,282
Payables for professional services	95	259
Accrued interest payables on letters of credit and guarantees issued	12	17
Other	–	1
	811	**3,931**
Other non-financial liabilities		
Payable to employees	2,078	1,488
Deferred income	137	394
Taxes, other than income tax	78	89
	2,293	**1,971**
Other liabilities	**3,104**	**5,902**

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

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

	31 December 2013	*31 December 2012*
Short-term deposits from banks	69,882	4,277
Loans from the National Fund for Support of Entrepreneurship	35,816	28,753
Amount due to Azerbaijan Mortgage Fund	1,572	1,478
Correspondent accounts with other banks	16	2
Loans from the Central Bank of the Republic of Azerbaijan	–	535
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	**107,286**	**35,045**

As at 31 December 2013, the Bank received short-term funds from one resident commercial bank (2012 – nil) and one non-resident commercial bank (2012 – one) comprising AZN 69,882 thousands (2012 – AZN 4,277 thousands) maturing on 19 November 2014 (2012 – 21 January 2013) and with annual interest rate of 3%-5% p.a. (2012 – 5% p.a.).

As at 31 December 2013, the Bank had loans received from the National Fund for Support of Entrepreneurship amounting to AZN 35,816 thousands (2012 – AZN 28,753 thousands), maturing through May 2023 (2012 – through February 2022), and bearing annual interest rate of 1% p.a. 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% p.a. (2012 – 6%-7% p.a.).

As at 31 December 2013, the Bank had loans refinanced from the Azerbaijan Mortgage Fund amounting to AZN 1,572 thousands (2012 – AZN 1,478 thousands), maturing through August 2037 (2012 – through May 2037) and bearing annual interest rate of 4% p.a. (2012 – 4% p.a.).

As at 31 December 2012, the Bank had a loan from the CBAR amounting to AZN 535 thousands matured in February 2013 with annual interest rate of 6% p.a. The loan was repaid at maturity.

(Figures in tables are in thousands of Azerbaijani manats)

17. Amounts due to customers

The amounts due to customers include the following:

	31 December 2013	*31 December 2012*
Demand deposits	183,471	263,209
Time deposits	119,346	193,858
Amounts due to customers	**302,817**	**457,067**
Held as security against guarantees issued (Note 21)	**380**	**120**

An analysis of customer accounts by economic sector follows:

	31 December 2013	*31 December 2012*
Individuals	118,701	279,085
Investment holding companies	99,511	119,636
Trade and services	37,449	27,958
Insurance	15,052	7,461
Construction	9,328	10,008
Public organizations	6,814	3,919
Hotel business	4,243	–
Manufacturing	3,930	2,235
Transport and communication	2,501	2,779
Non banking credit organizations	802	–
Energy	102	1
Agriculture	30	536
Other	4,354	3,449
Amounts due to customers	**302,817**	**457,067**

As at 31 December 2013, customer deposits included balances with five largest customers comprised AZN 168,872 thousands or 56% of the total customer deposits portfolio (2012 – AZN 347,917 thousands or 76% of the total customer deposits portfolio).

18. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	31 December 2013	*31 December 2012*
Commerzbank Aktiengesellschaft	26,437	19,389
Raiffeisen Bank International Aktiengesellschaft	7,422	7,748
Landesbank Baden-Württemberg	3,254	3,798
UBI BANCA (UNIONE DI BANCHE ITALIANE) S.C.P.A.	117	–
Amsterdam Trade Bank N.V.	22	–
Amounts due to credit institutions	**37,252**	**30,935**

As at 31 December 2013, amounts due to credit institutions included balances with five (2012 – three) foreign banks amounting to AZN 37,252 thousands (2012 – AZN 30,935 thousands), maturing through April 2021 (2012 – through April 2021) and bearing annual interest rate of 1.40%-37.05% p.a. (2012 – 1.91%-6.76% p.a.). These unsecured borrowings are for trade finance of import operations (letters of credit) of the customers of the Bank.

(Figures in tables are in thousands of Azerbaijani manats)

19. Taxation

The corporate income tax expense comprises:

	Year ended 31 December 2013	*Year ended 31 December 2012*
Current tax charge	(4,254)	(3,029)
Prior year tax expense actualisation	(139)	–
Deferred tax credit/(charge)	302	(1,522)
Income tax expense	**(4,091)**	**(4,551)**

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

	Year ended 31 December 2013	*Year ended 31 December 2012*
Net gains/(losses) on investment securities available-for-sale	56	(47)
Income tax credited/(charged) to other comprehensive income	**56**	**(47)**

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 2013	*Year ended 31 December 2012*
Profit before income tax expense	**16,119**	**20,762**
Statutory tax rate	20%	20%
Theoretical tax expense at the statutory rate	**(3,224)**	**(4,152)**
Tax effect of non–deductible expenses	(345)	(448)
Unrecognized deferred tax assets	(265)	–
Prior year tax expense actualisation	(139)	–
Effect of different tax rates in other country	(86)	–
Tax effect of tax–exempt income	21	–
Other	(53)	49
Income tax expense	**(4,091)**	**(4,551)**

(Figures in tables are in thousands of Azerbaijani manats)

19. Taxation (continued)

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

	2011	Origination and reversal of temporary differences: In the statement of profit or loss	Origination and reversal of temporary differences: In other comprehensive income	2012	Origination and reversal of temporary differences: In the statement of profit or loss	Origination and reversal of temporary differences: In other comprehensive income	2013
Tax effect of deductible temporary differences:							
Tax losses carried forward	–	–	–	–	–	265	265
Investment securities available-for-sale	2	–	(2)	–	–	11	11
Loans to customers	148	24	–	172	5	–	177
Property and equipment	32	(32)	–	–	–	–	–
Other assets	–	12	–	12	(12)	–	–
Other liabilities	464	(15)	–	449	91	–	540
Gross deferred tax assets	**646**	**(11)**	**(2)**	**633**	**84**	**276**	**993**
Unrecognised deferred tax asset	–	–	–	–	–	(265)	(265)
Deferred tax asset	**646**	**(11)**	**(2)**	**633**	**84**	**11**	**728**
Tax effect of taxable temporary differences:							
Trading securities	–	(208)	–	(208)	89	–	(119)
Amounts due from credit institutions	(59)	(105)	–	(164)	96	–	(68)
Investment securities available-for-sale	–	–	(45)	(45)	–	45	–
Loans to banks	(6)	2	–	(4)	(52)	–	(56)
Loans to customers	(891)	(1,055)	–	(1,946)	150	–	(1,796)
Property and equipment	–	(89)	–	(89)	(214)	–	(303)
Intangible assets	(20)	1	–	(19)	(27)	–	(46)
Provision for guarantees and letters of credit	(428)	(57)	–	(485)	176	–	(309)
Deferred tax liabilities	**(1,404)**	**(1,511)**	**(45)**	**(2,960)**	**218**	**45**	**(2,697)**
Net deferred tax liabilities	**(758)**	**(1,522)**	**(47)**	**(2,327)**	**302**	**56**	**(1,969)**

20. Equity

As at 31 December 2013, the Bank authorized, issued and fully paid capital amounted to AZN 228,000 thousands (2012 – AZN 157,000 thousands) comprising of 10,000 ordinary shares with a par value of AZN 22,800.00 per share (2012 – AZN 15,700.00). Each ordinary share entitles one vote to the shareholder.

On 1 February 2012, the shareholders decided to increase the share capital by AZN 10,750 thousands through capitalization of the profit earned for the year ended 31 December 2011 and by AZN 2,645 thousands amount reserved for increase in share capital.

On 17 April 2012, the shareholders of the Bank decided to increase share capital of the Bank by additional cash contribution amounting of AZN 20,130 thousands. Increase of share capital was finalized on 29 June 2012. As a result the share capital was increased from AZN 123,475 thousands to AZN 157,000 thousands.

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

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

20. Equity (continued)

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

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

Foreign currency translation reserve

Foreign currency translation reserve is used to record exchange difference arising from the translation of the financial statements of foreign subsidiary.

Unrealised gains (losses) on investment securities available-for-sale

This reserve records fair value changes on available-for-sale investments.

21. 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 statement of financial position in a manner not currently determinable.

Legal

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

(Figures in tables are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)

Taxation

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

Management believes that its interpretation of the relevant legislation as at 31 December 2013 is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Insurance

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

Compliance with the CBAR ratios

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

As a result of this non-compliance the Bank provided to the CBAR an action plan on how these breaches are going to be rectified. The plan contains a complete list of measures that would rectify current breach and will bring the Bank into compliance with the CBAR statutory requirement by 01 July 2014. Subsequently on 17 January 2014 the Bank received a clearance letter from the CBAR regarding acceptance of the action plan and non-application of sanctions against the Bank.

Financial commitments and contingencies

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

(Figures in tables are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)

Financial commitments and contingencies comprise:

	31 December 2013	*31 December 2012*
Credit-related commitments		
Guarantees issued	44,160	54,794
Unused credit lines	26,635	36,582
Letters of credit	11,093	15,919
	81,888	**107,295**
Operating lease commitments		
Not later than 1 year	726	279
Later than 1 year but not later than 5 years	1,471	1,415
Later than 5 years	150	300
	2,347	**1,994**
Less – provisions (Note 22)	(150)	(967)
Commitments and contingencies (before deducting collateral)	**84,085**	**108,322**
Less – cash held as security against guarantees issued (Note 17)	(380)	(120)
Commitments and contingencies	**83,705**	**108,202**

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

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

	Year ended 31 December 2013			
	Corporate lending	*Individual lending*	*Total loans to customers*	*Guarantees and letters of credit*
At 1 January	**(8,066)**	**(630)**	**(8,696)**	**(967)**
(Charge)/reversal for the year	(13,832)	117	(13,715)	817
Amounts written off	412	261	673	–
At 31 December	**(21,486)**	**(252)**	**(21,738)**	**(150)**

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

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

(Figures in tables are in thousands of Azerbaijani manats)

23. Net fee and commission income

Net fee and commission income comprise:

	Year ended 31 December 2013	*Year ended 31 December 2012*
Guarantees and letters of credit	2,179	2,338
Settlements operations	1,199	940
Servicing plastic card operations	1,125	712
Securities operations	800	514
Cash operations	692	866
Other	10	23
Fee and commission income	**6,005**	**5,393**
Servicing plastic card operations	(1,414)	(764)
Settlements operations	(798)	(326)
Guarantees and letters of credit	(606)	(635)
Securities operations	(99)	(113)
Cash operations	(8)	(8)
Other	(42)	(4)
Fee and commission expense	**(2,967)**	**(1,850)**
Net fee and commission income	**3,038**	**3,543**

24. Personnel, general and administrative expenses

Personnel expenses comprise:

	Year ended 31 December 2013	*Year ended 31 December 2012*
Salaries and bonuses	(7,851)	(5,063)
Social security costs	(1,626)	(1,092)
Other employee related expenses	(1,424)	(1,283)
Total personnel expenses	**(10,901)**	**(7,438)**

(Figures in tables are in thousands of Azerbaijani manats)

24. Personnel, general and administrative expenses (continued)

General and administrative expenses comprise:

	Year ended 31 December 2013	*Year ended 31 December 2012*
Operating leases	(2,181)	(991)
Professional services	(2,170)	(1,696)
Advertising costs	(1,266)	(942)
Charity and sponsorship	(689)	(1,246)
Software cost	(578)	(475)
Transportation and business trip expenses	(386)	(307)
Utilities	(336)	(93)
Insurance	(274)	(187)
Security expenses	(161)	(109)
Repair and maintenance	(148)	(103)
Communications	(140)	(109)
Taxes, other than income tax	(114)	(77)
Stationery	(111)	(115)
Printing expenses	(55)	(19)
Membership fees	(37)	(29)
Other expenses	(449)	(233)
Total general and administrative expenses	**(9,095)**	**(6,731)**

25. 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.

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Introduction (continued)

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.

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Introduction (continued)

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Credit risk (continued)

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*	*Standard grade*	*Sub-standard grade*	*Past due but not impaired*	*Individually impaired*	*Total*
31 December 2013							
Amounts due from credit institutions	7	–	32,639	–	–	–	32,639
Investment securities available-for-sale	8	135,521	–	–	20,605	–	156,126
Loans to banks	9	–	14,107	–	–	–	14,107
Loans to customers	10						
Corporate lending		–	266,004	3,717	32,018	27,200	328,939
Individual lending		–	21,440	–	–	577	22,017
Total		**135,521**	**334,190**	**3,717**	**52,623**	**27,777**	**553,828**

		Neither past due nor impaired					
	Notes	*High grade*	*Standard grade*	*Sub-standard grade*	*Past due but not impaired*	*Individually impaired*	*Total*
31 December 2012							
Amounts due from credit institutions	7	–	14,960	–	–	–	14,960
Investment securities available-for-sale	8	287,379	36,320	–	–	–	323,699
Loans to banks	9	–	1,000	–	–	–	1,000
Loans to customers	10						
Corporate lending		–	236,725	–	–	25,891	262,616
Individual lending		–	19,651	–	–	570	20,221
Total		**287,379**	**308,656**	**–**	**–**	**26,461**	**622,496**

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.

25. Risk management (continued)

Credit risk (continued)

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 incurred 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.

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Credit risk (continued)

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

	31 December 2013				*31 December 2012*			
	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	26,588	19,013	2,455	48,056	50,026	1,801	16,699	68,526
Trading securities	51,717	–	–	51,717	14,180	–	–	14,180
Amounts due from credit institutions	25,907	342	6,390	32,639	14,622	338	–	14,960
Investment securities available-for-sale	129,996	–	26,130	156,126	287,379	–	36,320	323,699
Loans to banks	14,107	–	–	14,107	1,000	–	–	1,000
Loans to customers	321,232	–	7,986	329,218	266,923	–	7,218	274,141
Other financial assets	849	–	–	849	242	–	–	242
	570,396	19,355	42,961	632,712	634,372	2,139	60,237	696,748
Financial liabilities								
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	106,474	812	–	107,286	30,894	–	4,151	35,045
Amounts due to customers	302,621	–	196	302,817	457,067	–	–	457,067
Amounts due to credit institutions	–	37,252	–	37,252	–	30,935	–	30,935
Other financial liabilities	755	27	29	811	3,893	38	–	3,931
	409,850	38,091	225	448,166	491,854	30,973	4,151	526,978
Net assets	160,546	(18,736)	42,736	184,546	142,518	(28,834)	56,086	169,770

Liquidity risk and funding management

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

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

The liquidity position is assessed and managed by the Bank based on certain liquidity ratios established by the CBAR. As at 31 December 2013 and 2012, these ratios were as follows:

	31 December 2013, %	*31 December 2012, %*
Instant Liquidity Ratio (30% is the minimum required by the CBAR) (assets receivable or realisable within one day/liabilities repayable on demand)	125	114

As at 31 December 2013 the Subsidiary's liquidity ratio (average volume of liquid assets/average volume of liabilities) based on requirements established by NBG was 275%.

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2013 and 2012 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	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total 2013*
As at 31 December 2013					
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	32,851	48,476	21,413	14,079	116,819
Amounts due to customers	223,366	63,214	23,756	–	310,336
Amounts due to credit institutions	5,495	16,734	694	17,963	40,886
Other financial liabilities	822	12	–	–	834
Total undiscounted financial liabilities	**262,534**	**128,436**	**45,863**	**32,042**	**468,875**

Financial liabilities	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total 2012*
As at 31 December 2012					
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	6,124	4,996	19,323	5,974	36,417
Amounts due to customers	372,670	72,709	13,511	–	458,890
Amounts due to credit institutions	9,382	12,298	8,479	2,037	32,196
Other financial liabilities	3,931	–	–	–	3,931
Total undiscounted financial liabilities	**392,107**	**90,003**	**41,313**	**8,011**	**531,434**

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 at 31 December 2013	34,786	24,089	4,681	18,332	**81,888**
As at 31 December 2012	49,153	33,595	7,277	17,270	**107,295**

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.

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

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 2013. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2013 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 statement of financial position and statement of cash flows.

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

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Currency risk (continued)

As at 31 December 2013, the Bank had the following exposure to foreign currency exchange rate risk:

	AZN	*USD*	*EUR*	*Other*	*Total 2013*
Financial assets					
Cash and cash equivalents	16,977	19,572	9,408	2,099	48,056
Trading securities	51,717	–	–	–	51,717
Amounts due from credit institutions	9,374	10,039	9,829	3,397	32,639
Investment securities available-for-sale	129,996	20,605	–	5,525	156,126
Loans to banks	1,510	12,209	388	–	14,107
Loans to customers	251,403	32,181	44,872	762	329,218
Other financial assets	223	127	499	–	849
Total financial assets	**461,200**	**94,733**	**64,996**	**11,783**	**632,712**
Financial liabilities					
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	59,393	47,891	2	–	107,286
Amounts due to customers	227,578	39,284	35,791	164	302,817
Amounts due to credit institutions	–	21,778	15,474	–	37,252
Other financial liabilities	735	32	36	8	811
Total financial liabilities	**287,706**	**108,985**	**51,303**	**172**	**448,166**
Net financial position	**173,494**	**(14,252)**	**13,693**	**11,611**	**184,546**

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

	AZN	*USD*	*EUR*	*Other*	*Total 2012*
Financial assets					
Cash and cash equivalents	38,584	9,304	3,422	17,216	68,526
Trading securities	14,180	–	–	–	14,180
Amounts due from credit institutions	12,013	2,845	102	–	14,960
Investment securities available-for-sale	287,379	36,320	–	–	323,699
Loans to banks	1,000	–	–	–	1,000
Loans to customers	198,251	31,178	44,712	–	274,141
Other financial assets	92	34	113	3	242
Total financial assets	**551,499**	**79,681**	**48,349**	**17,219**	**696,748**
Financial liabilities					
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	30,766	2	4,277	–	35,045
Amounts due to customers	402,070	30,954	23,957	86	457,067
Amounts due to credit institutions	–	12,254	18,681	–	30,935
Other financial liabilities	3,608	193	128	2	3,931
Total financial liabilities	**436,444**	**43,403**	**47,043**	**88**	**526,978**
Net financial position	**115,055**	**36,278**	**1,306**	**17,131**	**169,770**

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Currency risk (continued)

Currency risk sensitivity

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

Impact on profit before tax based on assets value as at 31 December 2013 and 2012:

	31 December 2013		*31 December 2012*	
	AZN/USD +10%	*AZN/USD -10%*	*AZN/USD +10%*	*AZN/USD -10%*
Impact on profit before tax	1,425	(1,425)	(3,628)	3,628

	31 December 2013		*31 December 2012*	
	AZN/EUR +10%	*AZN/EUR -10%*	*AZN/EUR +10%*	*AZN/EUR -10%*
Impact on profit before tax	(1,369)	1,369	(130)	130

26. Fair values of financial instruments

Fair value hierarchy

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

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

(Figures in tables are in thousands of Azerbaijani manats)

26. Fair values of financial instruments (continued)

Fair value hierarchy (continued)

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

Fair value hierarchy for financial instruments measured at fair value as at 31 December 2012

At 31 December 2012	*Level 1*	*Level 2*	*Level 3*	*Total*
Financial assets				
Trading securities	14,180	–	–	14,180
Investment securities available-for-sale	246,388	77,311	–	323,699
	260,568	**77,311**	–	**337,879**

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.

(Figures in tables are in thousands of Azerbaijani manats)

26. Fair values of financial instruments (continued)

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

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

	Carrying value 2013	*Fair value 2013*	*Unrecognized gain/(loss) 2013*	*Carrying value 2012*	*Fair value 2012*	*Unrecognized gain/(loss) 2012*
Financial assets						
Cash and cash equivalents	48,056	48,056	–	68,526	68,526	–
Amounts due from credit institutions	32,639	32,639	–	14,960	14,960	–
Loans to banks	14,107	14,107	–	1,000	1,000	–
Loans to customers	329,218	329,218	–	274,141	274,141	–
Financial liabilities						
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	107,286	107,286	–	35,045	35,045	–
Amounts due to customers	302,817	302,817	–	457,067	457,067	–
Amounts due to credit institutions	37,252	37,252	–	30,935	30,935	–
Total unrecognised change in unrealised fair value			–			–

Assets for which fair value approximates carrying value

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

Fixed and variable rate financial instruments

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

Movements in level 3 assets and liabilities at fair value

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

	At 1 January 2013	*Purchases*	*Interest income*	*Settlements*	*Currency translation difference*	*At 31 December 2013*
Assets						
Investment securities available-for-sale	–	12,890	141	(7,268)	(238)	5,525
	–	**12,890**	**141**	**(7,268)**	**(238)**	**5,525**

(Figures in tables are in thousands of Azerbaijani manats)

27. 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 25 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	31 December 2013			*31 December 2012*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	48,056	–	48,056	68,526	–	68,526
Trading securities	35,465	16,252	51,717	4,915	9,265	14,180
Amounts due from credit institutions	32,639	–	32,639	14,960	–	14,960
Investment securities available-for-sale	10,228	145,898	156,126	106,550	217,149	323,699
Loans to banks	14,107	–	14,107	1,000	–	1,000
Loans to customers	158,731	170,487	329,218	139,827	134,314	274,141
Investment property	–	2,000	2,000	–	2,000	2,000
Property and equipment	–	14,389	14,389	–	8,900	8,900
Intangible assets	–	3,989	3,989	–	2,278	2,278
Prepayment for equity investment	–	41,971	41,971	–	–	–
Other assets	3,533	6,310	9,843	7,222	4,169	11,391
Total assets	**302,759**	**401,296**	**704,055**	**343,000**	**378,075**	**721,075**
Amounts due to the Central Bank of the Republic of Azerbaijan, banks and government funds	78,921	28,365	107,286	4,923	30,122	35,045
Amounts due to customers	282,583	20,234	302,817	442,247	14,820	457,067
Amounts due to credit institutions	32,442	4,810	37,252	21,229	9,706	30,935
Current income tax liabilities	1,562	–	1,562	484	–	484
Deferred income tax liabilities	–	1,969	1,969	–	2,327	2,327
Provision for guarantees and letters of credit	150	–	150	967	–	967
Dividends payable to shareholders	14,992	–	14,992	–	–	–
Other liabilities	3,034	70	3,104	5,857	45	5,902
Total liabilities	**413,684**	**55,448**	**469,132**	**475,707**	**57,020**	**532,727**
Net	**(110,925)**	**345,848**	**234,923**	**(132,707)**	**321,055**	**188,348**

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

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

28. 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.

(Figures in tables are in thousands of Azerbaijani manats)

28. Related party disclosures (continued)

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 2013					31 December 2012				
	Parent	*Entities under common control*	*Key management personnel*	*Other*	*Total*	*Parent*	*Entities under common control*	*Key management personnel*	*Other*	*Total*
Amounts due from credit institutions	–	9,724	–	–	9,724	–	–	–	–	–

	31 December 2013					31 December 2012				
	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	**20**	**8,836**	**471**	**–**	**9,327**	**16**	**21,904**	**299**	**–**	**22,219**
Accrued interest income at 1 January	3	36	4	–	43	–	85	5	–	90
Loans outstanding at 1 January, gross	**23**	**8,872**	**475**	**–**	**9,370**	**16**	**21,989**	**304**	**–**	**22,309**
Loans issued during the year	–	20,063	2,055	–	22,118	4	8,092	709	4	8,809
Loan repayments during the year	–	(15,685)	(1,530)	–	(17,215)	–	(21,245)	(542)	(4)	(21,791)
Interest accrual	2	217	3	–	222	3	36	4	–	43
Loans outstanding at 31 December, gross	**25**	**13,467**	**1,003**	**–**	**14,495**	**23**	**8,872**	**475**	**–**	**9,370**
Less: allowance for impairment at 31 December	–	(35)	–	–	(35)	–	(64)	(3)	–	(67)
Loans outstanding at 31 December, net	**25**	**13,432**	**1,003**	**–**	**14,460**	**23**	**8,808**	**472**	**–**	**9,303**
Interest income on loans	2	1,051	65	–	1,118	2	3,519	37	–	3,558

(Figures in tables are in thousands of Azerbaijani manats)

28. Related party disclosures (continued)

	31 December 2013					*31 December 2012*				
	Parent	*Entities under common control*	*Key management personnel*	*Other*	*Total*	*Parent*	*Entities under common control*	*Key management personnel*	*Other*	*Total*
Deposits at 1 January	47,555	5,200	374	91,793	144,922	47,560	7,000	375	62,593	117,528
Accrued interest expense at 1 January	63	30	–	148	241	–	–	–	–	–
Deposit at 1 January	47,618	5,230	374	91,941	145,163	47,560	7,000	375	62,593	117,528
Deposits received during the year	25,984	6,800	350	83,332	**116,466**	15,200	6,114	–	174,231	**195,545**
Deposits repaid during the year	(72,554)	–	(453)	(107,017)	**(180,024)**	(15,205)	(7,914)	(1)	(145,031)	**(168,151)**
Interest accrual	(60)	14	1	(60)	**(105)**	63	30	–	148	**241**
Deposits at 31 December	**988**	**12,044**	**272**	**68,196**	**81,500**	**47,618**	**5,230**	**374**	**91,941**	**145,163**
Current accounts at 31 December	15,178	97,279	477	26,011	**138,945**	7,139	54,841	219	166,900	**229,099**
Interest expense on deposits	(2,046)	(1,224)	(31)	(3,090)	**(6,391)**	(3,872)	(409)	(35)	(4,105)	**(8,421)**
Guarantees issued	–	–	–	–	–	–	35	–	–	**35**
Letters of credit issued	–	–	–	–	–	–	36	–	–	**36**
Unused credit lines	73	969	62	11	**1,115**	71	6,139	118	15	**6,343**
Fee and commission income	13	615	1	2	**631**	43	464	1	2	**510**
Net gains/(losses) from foreign currencies: dealing	40	546	1	93	**680**	2	159	–	47	**208**
Other operating expenses	(59)	(2,220)	–	(35)	**(2,314)**	–	(817)	–	(70)	**(887)**

Compensation to members of key management personnel was comprised of the following:

	Year ended 31 December 2013	***Year ended 31 December 2012***
Salaries and other benefits	(2,176)	(1,804)
Social security costs	(379)	(351)
Total key management compensation	**(2,555)**	**(2,155)**

29. Capital adequacy

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

29. Capital adequacy (continued)

CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum capital adequacy ratio of 12% of risk-weighted assets for regulatory capital. As at 31 December 2013 and 2012 the Bank's capital adequacy ratio on this basis was as follows:

	31 December 2013	*31 December 2012*
Tier 1 capital	228,000	165,809
Tier 2 capital	7,336	18,403
Less: Deductions from capital	(20,140)	(18,893)
Total regulatory capital	**215,196**	**165,319**
Risk-weighted assets	**591,258**	**490,752**
Capital adequacy ratio	**36%**	**34%**

NBG capital adequacy ratio

NBG requires banks to maintain a minimum total capital adequacy ratio of 12% of risk-weighted assets for regulatory capital. As at 31 December 2013, the Subsidiary's capital adequacy ratio was 130%.

30. Events after the reporting period

In late January 2014 market quotation of notes issue by Baghlan Group FZCO (the "Issuer") started to gradually decrease from its year end price of 99.5 per note and by the end of February 2014 comprised 90.0 per note. Management believes that the decline in market quotation was due to non-payment by the Issuer of quarterly coupon payment on 27 December 2013 and till its grace period (15 days) after which the market quotation started to decline. As at the consolidated financial statements issue date, the Issuer has partially paid overdue coupon.

On 14 February 2014, the General Shareholders Meeting of the Bank decided to increase share capital of the Bank by additional cash contribution amounting to AZN 105,000 thousands. The increase will be carried out by increasing par value of 10,000 outstanding ordinary shares from AZN 22,800.00 per ordinary share to AZN 33,300.00 per ordinary share.