# OJSC Expressbank

## Financial statements

*Year ended 31 December 2012*
*Together with Independent auditors' report*

# Contents

## Independent auditors' report



## Notes to financial statements

Ernst & Young

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

Ernst & Yang Holdinqs (SiAyEs) Bi.Vi.
Port Baku Tauers Biznes Markazi
Canub 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 Express Bank

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

***Management's responsibility for the financial statements***

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

***Auditors' responsibility***

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

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

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

***Opinion***

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

Ernst & Young Holdings (CIS) B.V.

30 May 2013

## Statement of financial position

## As at 31 December 2012

*(Thousands of Azerbaijani manats)*

| | Notes | 31 December 2012 | 31 December 2011 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 5 | 125,966 | 79,750 |
| Amounts due from credit institutions | 6 | 4,101 | 1,345 |
| Loans to banks | 7 | 6,000 | – |
| Loans to customers | 8 | 103,529 | 80,352 |
| Property and equipment | 9 | 5,625 | 5,180 |
| Intangible assets | 10 | 2,416 | 427 |
| Foreclosed property | 11 | 294 | 294 |
| Other assets | 12 | 1,885 | 3,301 |
| **Total assets** | | **249,816** | **170,649** |
| **Liabilities** | | | |
| Amounts due to customers | 13 | 146,914 | 82,825 |
| Amounts due to credit institutions | 14 | – | 8,360 |
| Current income tax liability | | 1,487 | – |
| Deferred income tax liabilities | 15 | 346 | – |
| Other liabilities | 12 | 557 | 488 |
| Advances from shareholders for increase in share capital | 16 | – | 667 |
| **Total liabilities** | | **149,304** | **92,340** |
| **Equity** | | | |
| Share capital | 16 | 87,407 | 66,672 |
| Retained earnings | | 13,105 | 11,637 |
| **Total equity** | | **100,512** | **78,309** |
| **Total liabilities and equity** | | **249,816** | **170,649** |

**Signed and authorized for release on behalf of the Management Board of the Bank:**

Mr. Emin Mammadov — Chairman of the Management Board

Mr. Anar Hajizada — Chief Financial Officer

Mrs. Sevda Fattayeva — Chief Accountant

"Expressbank" Açıq Səhmdar Cəmiyyəti Azərbaycan Respublikası
"Expressbank" Open Joint Stock Company Azerbaijan Republic

30 May 2013

*The accompanying notes on pages 5 to 35 are an integral part of these financial statements.*

## Statement of comprehensive income

## For the year ended 31 December 2012

*(Thousands of Azerbaijani manats)*

| | *Notes* | *Year ended 31 December 2012* | *Year ended 31 December 2011* |
|---|---|---|---|
| **Interest income** | | | |
| Loans to customers | | 21,466 | 13,493 |
| Amounts due from credit institutions | | 320 | 328 |
| Investment securities | | 21 | 146 |
| Loans to banks | | – | 473 |
| | | **21,807** | **14,440** |
| **Interest expense** | | | |
| Amounts due to customers | | (4,421) | (2,999) |
| Amounts due to credit institutions | | (38) | (46) |
| | | **(4,459)** | **(3,045)** |
| **Net interest income** | | **17,348** | **11,395** |
| Provision for impairment of interest bearing assets | 8 | (160) | (190) |
| **Net interest income after provision for impairment of interest bearing assets** | | **17,188** | **11,205** |
| Net fee and commission income | 18 | 3,633 | 1,220 |
| Net gains from dealing operations | | 5,716 | 6,969 |
| Net (losses)/gains from currency translation differences | | (4) | (199) |
| Other income | | 2 | 4 |
| **Non-interest income** | | **9,347** | **7,994** |
| Personnel expenses | 19 | (5,232) | (3,809) |
| Depreciation and amortization | 9,10 | (2,087) | (1,510) |
| General and administrative expenses | 19 | (3,080) | (2,110) |
| Other impairment and provisions | | (3) | – |
| **Non-interest expenses** | | **(10,402)** | **(7,429)** |
| **Profit before income tax expense** | | **16,133** | **11,770** |
| Income tax expense | 15 | (3,197) | (65) |
| **Net profit for the year** | | **12,936** | **11,705** |
| Other comprehensive income for the year | | – | – |
| **Total comprehensive income for the year** | | **12,936** | **11,705** |

*The accompanying notes on pages 5 to 33 are an integral part of these financial statements.*

## Statement of changes in equity

## For the year ended 31 December 2012

*(Thousands ofAzerbaijani manats)*

| | *Share Capital* | *Retained earnings* | *Total* |
|---|---|---|---|
| **31 December 2010** | **51,000** | **5,796** | **56,796** |
| Capitalization of net profit for the year 2010 to share capital (Note 16) | 5,672 | (5,672) | **–** |
| Cash contribution for share capital increase (Note 16) | 10,000 | – | **10,000** |
| Profit tax on difference between capitalized IFRS and tax profits | – | (192) | **(192)** |
| Total comprehensive income for the year | – | 11,705 | **11,705** |
| **31 December 2011** | **66,672** | **11,637** | **78,309** |
| Capitalization of net profit for the year 2011 to share capital (Note 16) | 11,458 | (11,458) | **–** |
| Use of retained earnings for increase in share capital (Note 16) | 10 | (10) | **–** |
| Capitalization of amount reserved for increase in share capital (Notes 16) | 667 | – | **667** |
| Cash contribution for share capital increase (Note 16) | 8,600 | – | **8,600** |
| Total comprehensive income for the year | – | 12,936 | **12,936** |
| **31 December 2012** | **87,407** | **13,105** | **100,512** |

*The accompanying notes on pages 5 to 33 are an integral part of these financial statements.*

## Statement of cash flows

## For the year ended 31 December 2012

*(Thousands of Azerbaijani manats)*

| | *Notes* | *Year ended 31 December 2012* | *Year ended 31 December 2011* |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Interest received | | 21,968 | 13,766 |
| Interest paid | | (4,258) | (1,959) |
| Fees and commissions received | | 4,254 | 2,812 |
| Fees and commissions paid | | (691) | (1,354) |
| Realized gains less losses from dealing in foreign currencies | | 5,716 | 6,968 |
| Other income received | | 2 | 4 |
| Personnel expenses paid | | (5,232) | (3,661) |
| General and administrative expenses paid | | (3,018) | (2,110) |
| **Cash flows from operating activities before changes in operating assets and liabilities** | | **18,741** | **14,466** |
| *Net (increase)/decrease in operating assets* | | | |
| Amounts due from credit institutions | | (2,916) | (226) |
| Loans to banks | | (6,000) | 4,000 |
| Loans to customers | | (23,505) | (32,900) |
| Other assets | | 119 | (628) |
| *Net increase/(decrease) in operating liabilities* | | | |
| Amounts due to customers | | 62,613 | 6,441 |
| Amounts due to credit institutions | | (8,359) | 8,084 |
| Other liabilities | | 24 | (729) |
| **Net cash flows from/(used in) operating activities before income tax** | | **40,717** | **(1,492)** |
| Income tax paid | | (1,209) | (296) |
| **Net cash flows from/(used in) operating activities** | | **39,508** | **(1,788)** |
| **Cash flows from investing activities** | | | |
| Proceeds from sale and redemption of investment securities | | – | 9,726 |
| Purchase of property and equipment | | (2,340) | (2,558) |
| Acquisition of intangible assets | | (972) | (263) |
| **Net cash (used in)/from investing activities** | | **(3,312)** | **6,905** |
| **Cash flows from financing activities** | | | |
| Proceeds from issuance of share capital | 16 | 8,600 | 10,000 |
| **Net cash from financing activities** | | **8,600** | **10,000** |
| Effect of exchange rates changes on cash and cash equivalents | | 1,420 | (199) |
| **Net increase in cash and cash equivalents** | | **46,216** | **14,918** |
| **Cash and cash equivalents, beginning** | 5 | **79,750** | **64,832** |
| **Cash and cash equivalents, ending** | 5 | **125,966** | **79,750** |

*The accompanying notes on pages 5 to 33 are an integral part of these financial statements.*

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 1. Principal activities

**OJSC Expressbank**(the "Bank") was formed on 21 June 1992 as Azernagliyyatbank Commercial Bank and operates under the laws of the Republic of Azerbaijan. On 11 March 2005 the legal structure of the Bank was changed to Open Joint Stock Company. The Bank changed its name from Open Joint Stock Commercial Bank "Azernagliyyatbank" to Open Joint Stock Company "Expressbank" on 4 March 2011. The Bank operates under banking license number 119 issued by the Central Bank of the Republic of Azerbaijan (the "CBAR") on 30 December 1992.

The Bank accepts deposits from the public and extends credit, transfers payments in Azerbaijan and abroad, exchanges currencies and provides other banking services to its commercial and retail customers. Its main office is in Baku and it has 15 branches (2011: 10) in Baku and other cities in Azerbaijan and 2 servicing outlets (2011: 4). The Bank's registered legal address is 21, A.Nakhchivani Street, Baku, Azerbaijan.

Starting from 07 August 2007, the Bank is a member of the deposit insurance system. The system operates under the Law on Deposit Insurance and other regulations and is governed by the Azerbaijan Deposit Insurance Fund. Insurance covers the Bank's liabilities to individual depositors for the amount up to AZN 30 thousands for each individual in case of business failure and revocation of the CBAR banking license.

As of 31 December, the following shareholders owned the outstanding shares of the Bank:

| ***Shareholder*** | ***2012***<br>***%*** | ***2011***<br>***%*** |
|---|---|---|
| "ADOR" LLC | 42.00 | 42.00 |
| "AZENCO" Group LLC | 40.00 | 40.00 |
| "EnerqoServis" LLC | 17.64 | 17.60 |
| "Avtoneqliyyatservis" | 0.36 | 0.40 |
| **Total** | **100.00** | **100.00** |

The Bank is ultimately controlled by "ADOR" LLC, a local Azerbaijani entity.

As of 31 December 2012 and 2011 the Management Board (the "Board") of the Bank is composed of the following members:

| ***Name*** | ***Position*** |
|---|---|
| Mr. Emin Mammadov | Chairman |
| Mr. Ali Imanov | Deputy Chairman |
| Mr. Ilham Habibullayev | Deputy Chairman |

## 2. Basis of preparation

### General

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

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

The Azerbaijani manat ("AZN") is the reporting and functional currency of the Bank as the majority of the transactions are denominated, measured, or funded in AZN. Transactions in other currencies are treated as transactions in foreign currencies. These financial statements are presented in thousands of AZN, except per share amounts and unless otherwise indicated.

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below, for example for investment securities available-for-sale and foreclosed property.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 3. Summary of significant accounting policies

### Reclassification

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

The following reclassifications have been made to the statement of comprehensive income and statement of cash flows as at 31 December 2011 to conform to 2012 presentation.

| | ***As previously reported (2011)*** | ***Effect of reclassification (2011)*** | ***As reclassified (2011)*** | ***Notes*** |
|---|---|---|---|---|
| **Statement of comprehensive income** | | | | |
| Commission income on currency conversion operations | 2,503 | (2,503) | – | a) |
| Net fee and commission income | 3,724 | (2,503) | 1,221 | a) |
| Net gains from foreign currency dealing | 4,465 | 2,503 | 6,968 | a) |
| **Statement of cash flows** | | | | |
| *Cash flows from operating activities* | | | | |
| Fees and commissions received | 5,315 | (2,503) | 2,812 | a) |
| Realized gains less losses from dealing in foreign currencies | 4,465 | 2,503 | 6,968 | a) |

a. Commission income on currency conversion operations in the amount of AZN 2,503 thousands has been reclasified to net gains from foreign currency dealing. Accordingly, fees and commissions received in statement of cash flows in the amount of AZN 2,503 thousands have been reclassified to realised gains less losses from dealing in foreign currencies.

### Changes in accounting policies

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

*Amendments to IFRS 7 Financial Instruments: Disclosures*

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

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

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

### Financial assets

*Initial recognition*

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

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 3. Summary of significant accounting policies (continued)

### Financial assets (continued)

*Date of recognition*

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

*Financial assets at fair value through profit or loss*

Financial assets classified as held for trading are included in the category ‘financial assets at fair value through profit or loss’. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognized in the statement of comprehensive income.

*Held-to-maturity investments*

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

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in statement of comprehensive income when the loans and receivables are derecognized or impaired, as well as through the amortization process.

*Available-for-sale financial assets*

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

*Determination of fair value*

The fair value for financial instruments traded in active market at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

*Offsetting*

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

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 3. Summary of significant accounting policies (continued)

### Financial assets (continued)

*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 if 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 amortized 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 current accounts with other credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

### 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 credit institutions and amounts due to customers. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the statement of comprehensive income when the borrowings are derecognised as well as through the amortisation process.

### Impairment of financial assets

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

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

For amounts due from credit institutions and loans to banks and 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.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 3. Summary of significant accounting policies (continued)

### Impairment of financial assets (continued)

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 the statement of comprehensive income. 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 statement of comprehensive income.

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.

*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 assets'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 statement of comprehensive income.

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

*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 coast and the current fair value, less any impairment loss on that investment previously recognized in the statement of comprehensive income – is reclassified from other comprehensive income to statement of comprehensive income. Impairment losses on equity investments are not reversed through statement of comprehensive income; increases in their fair value after impairment are recognized in other comprehensive income.

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

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 3. Summary of significant accounting policies (continued)

### Impairment of financial assets (continued)

*Renegotiated loans*

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

### Derecognition of financial assets and liabilities

*Financial assets*

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

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

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

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

*Financial liabilities*

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

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

### Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit and guarantees. Financial guarantees are initially recognized in the financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortized premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee. Any increase in the liability relating to financial guarantees is taken to profit or loss. The premium received is recognized in the statement of comprehensive income on a straight-line basis over the life of the guarantee.

### 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.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 3. Summary of significant accounting policies (continued)

### Taxation (continued)

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

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

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.

### Intangible assets

Intangible assets include computer software and licenses.

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 amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic lives of 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortization periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

### 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 equipment when that cost is incurred if the recognition criteria are met. The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis using the following useful lives:

| | *Years* |
|---|---|
| Buildings | 14 |
| Furniture and fixtures | 4 |
| Computers and office equipment | 4 |
| Vehicles | 4 |
| Other fixed assets | 5 |
| Leasehold improvements | 5 |

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end. Costs related to repairs and renewals are charged when incurred and included in general and administrative expenses, unless they qualify for capitalization.

Assets under construction includes assets being constructed by the Bank and completed assets which are not yet ready for intended use. The assets are transferred from Assets under construction category to the respective category of Property and Equipment and depreciation of these assets commences at the time when the assets are put into use.

### Foreclosed property

The Bank classifies a non-current asset which the Bank took possession of in respect of non-performing loans, and is in the process of selling as foreclosed property if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

The Bank measures a foreclosed property at the lower of its carrying amount and fair value less costs to sell. The Bank recognizes an impairment loss for any initial or subsequent write-down of the asset to fair value less costs to sell if events or changes in circumstance indicate that their carrying amount may be impaired.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 3. Summary of significant accounting policies (continued)

### Provisions

Provisions are recognized 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 significant post-retirement benefits.

### Segment reporting

The Bank's operations are in Azerbaijan and constitute a single operating segment – commercial banking. Accordingly, for purposes of IFRS 8 *Operating Segments*, the Bank is treated as one operating segment.

### 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 recognized as additional paid-in capital.

*Dividends*

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

### Contingencies

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

### Recognition of income and expenses

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

*Interest and similar income and expense*

For all financial instruments measured at amortized 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 recognized using the original effective interest rate applied to the new carrying amount.

*Fee and commission income*

Loan origination fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the loan. Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in profit or loss over the remaining period of the loan commitment. Where a loan commitment expires without resulting in a loan, the loan commitment fee is recognized in profit or loss on expiry. Loan servicing fees are recognized as revenue as the services are provided. All other commissions are recognized when services are provided.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 3. Summary of significant accounting policies (continued)

### Foreign currency translation

The financial statements are presented in Azerbaijani manats, 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 recognized in profit or loss 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.

The Bank mainly used the following official exchange rates in the preparation of these financial statements:

| | ***2012*** | ***2011*** |
|---|---|---|
| 1 US dollar | 0.7850 AZN | 0.7865 AZN |
| 1 Euro | 1.0377 AZN | 1.0178 AZN |

### Future changes in accounting policies

*Standards and interpretations issued but not yet effective*

*IFRS 9Financial Instruments*

In November 2009 and 2011 the IASB issued the first phase of IFRS 9 *Financial Instruments*. This Standard will eventually replace IAS 39 *Financial Instrument: Recognition and Measurement*. IFRS 9 becomes effective for financial years beginning on or after 1 January 2013. The first phase of IFRS 9 introduces new requirements on classification and measurement of financial instruments. In particular, for subsequent measurement all financial assets are to be classified at amortized cost or at fair value through profit or loss with the irrevocable option for equity instruments not held for trading to be measured at fair value through other comprehensive income. For financial liabilities designated at fair value through profit or loss using fair value option IFRS 9 requires the amount of change in fair value attributable to changes in credit risk to be presented in other comprehensive income. The Bank now evaluates the impact of the adoption of new Standard and considers the initial application date.

*IFRS 10 Consolidated Financial Statements*

IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in IAS 27. In addition IFRS 10 introduces specific application guidance for agency relationships. IFRS 10 replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. It also includes the issues raised in SIC-12 Consolidation –*Special Purpose Entities*. It is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The Bank expects that adoption of the standard will have no impact on its financial position or performance.

*IFRS 11 Joint Arrangements*

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

*IFRS 12 Disclosure of Interests in Other Entities*

IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. IFRS 12 is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. Adoption of the standard will require new disclosures to be made in the financial statements of the Bank but will have no impact on its financial position or performance.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 3. Summary of significant accounting policies (continued)

### Future changes in accounting policies (continued)

*IFRS 13 Fair Value Measurement*

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

*IAS 27 Separate Financial Statements (as revised in 2012)*

As a consequence of the new IFRS 10 and IFRS 12, what remains of IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The amendment becomes effective for annual periods beginning on or after 1 January 2013. Adoption of the standard will have no impact on the Bank's financial position or performance.

*IAS 28 Investments in Associates and Joint Ventures (as revised in 2012)*

As a consequence of the new IFRS 11 and IFRS 12. IAS 28 has been renamed IAS 28 *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates. The amendment becomes effective for annual periods beginning on or after 1 January 2013. Adoption of the standard will have 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 will not impact the Banks' financial position or performance and will become effective for annual periods beginning on or after 1 January 2013.

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

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

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

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

*Amendments to IAS 19 Employee Benefits*

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

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 3. Summary of significant accounting policies (continued)

### Future changes in accounting policies (continued)

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

The amendments to IAS 1 *Presentation of Financial Statements*, effective for annual periods beginning on or after 1 July 2012, change the grouping of items presented in other comprehensive income. Items that could be reclassified (or 'recycled') to profit or loss at a future point in time (for example, upon derecognition or settlement) would be presented separately from items that will never be reclassified. These amendments will have no effect on its financial position and performance.

*Improvements to IFRS*

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

- *IFRS 1 First-time Adoption of International Financial Reporting Standards:* This improvement clarifies that an entity that stopped applying IFRS in the past and chooses, or is required, to apply IFRS, has the option to re-apply IFRS 1. If IFRS 1 is not re-applied, an entity must retrospectively restate its financial statements as if it had never stopped applying IFRS;
- *IAS 1 Presentation of Financial Statements*: This improvement clarifies the difference between voluntary additional comparative information and the minimum required comparative information. Generally, the minimum required comparative information is the previous period;
- *IAS 16 Property Plant and Equipment*: This improvement clarifies that major spare parts and servicing equipment that meet the definition of property, plant and equipment are not inventory;
- *IAS 32 Financial Instruments, Presentation*: This improvement clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with IAS 12 *Income Taxes;*
- *IAS 34 Interim Financial Reporting*: The amendment aligns the disclosure requirements for total segment assets with total segment liabilities in interim financial statements. This clarification also ensures that interim disclosures are aligned with annual disclosures.

## 4. Significant accounting judgments and estimates

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

*Fair value of financial instruments*

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

*Allowance for loan impairment*

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its experienced judgment 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 judgment 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.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 4. Significant accounting judgments and estimates (continued)

*Taxation*

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

## 5. Cash and cash equivalents

Cash and cash equivalents comprise:

| | *31 December 2012* | *31 December 2011* |
|---|---|---|
| Cash on hand | 8,047 | 8,279 |
| Current accounts with the CBAR | 66,090 | 62,527 |
| Current accounts with other credit institutions | 51,829 | 8,944 |
| **Cash and cash equivalents** | **125,966** | **79,750** |

As of 31 December 2012, current accounts with other credit institutions included AZN 43,933 thousands placed with one foreign bank and AZN 5,679 thousands placed with one local bank (2011 – AZN 8,142 thousands placed with three local banks).

Non-cash transaction performed by the Bank during 2012 is represented by capitalization of net profit for the year 2011 (2011 – for the year 2010) to share capital in the amount of AZN 11,458 thousands (2011 – AZN 5,672 thousands) and capitalization of advances from shareholders for increase in share capital in the amount of AZN 667 thousands (2011 – nil).In

## 6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

| | *31 December 2012* | *31 December 2011* |
|---|---|---|
| Obligatory reserve with the CBAR | 2,542 | 1,341 |
| Blocked accounts | 1,559 | 4 |
| **Amounts due from credit institutions** | **4,101** | **1,345** |

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

Blocked deposit as of 31 December 2012 relates to guarantee letter issued by the Bank and blocked in a non-resident bank.

## 7. Loans to banks

As of 31 December 2012 the Bank had outstanding amount of AZN 6,000 thousands (2011 – nil) of unsecured loan denominated in Azerbaijani Manat, issued to two resident commercial banks with contractual maturity through January 2013 (2011 – none) and annual average interest rate of 6.50% (2011 – none).

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 8. Loans to customers

Loans to customers comprise:

| | *31 December 2012* | *31 December 2011* |
|---|---|---|
| Corporate lending | 67,179 | 63,381 |
| Individuals lending | 38,453 | 18,866 |
| **Gross loans to customers** | **105,632** | **82,247** |
| Less – Allowance for impairment | (2,103) | (1,895) |
| **Loans to customers** | **103,529** | **80,352** |

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

| | *Corporate lending 2012* | *Individuals lending 2012* | *Total 2012* |
|---|---|---|---|
| **At 1 January 2012** | **(311)** | **(1,584)** | **(1,895)** |
| (Charge)/reversal for the year | 102 | (262) | **(160)** |
| Amounts written off | – | 201 | **201** |
| Recoveries | – | (249) | **(249)** |
| **At 31 December 2012** | **(209)** | **(1,894)** | **(2,103)** |
| Individual impairment | (82) | (143) | **(225)** |
| Collective impairment | (127) | (1,751) | **(1,878)** |
| | **(209)** | **(1,894)** | **(2,103)** |
| Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance | 1,737 | 367 | 2,104 |

| | *Corporate lending 2011* | *Individuals lending 2012* | *Total 2011* |
|---|---|---|---|
| **At 1 January 2011** | **(417)** | **(1,998)** | **(2,415)** |
| (Charge) for the year | (9) | (181) | **(190)** |
| Amounts written off | 177 | 596 | **773** |
| Recoveries | (62) | (1) | **(63)** |
| **At 31 December 2011** | **(311)** | **(1,584)** | **(1,895)** |
| Individual impairment | – | – | **–** |
| Collective impairment | (311) | (1,584) | **(1,895)** |
| | **(311)** | **(1,584)** | **(1,895)** |
| Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance | – | – | – |

### Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2012, comprised AZN 455 thousands (2011 – nil).

In accordance with the CBAR requirements, loans may only be written off with the approval of the Board of Directors and, in certain cases, with the respective decision of the Court.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 8. Loans to customers (continued)

### Collateral and other credit enhancements

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 corporate lending, government guarantees, real estate properties, inventory;
- For individuals lending, real estate properties, inventory, vehicles.

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.

### Concentration of loans to customers

As of 31 December 2012, the Bank had a concentration of loans represented by AZN 68,548 thousands due from ten largest borrowers (65% of gross loan portfolio) (2011 – AZN 63,244 thousands or 77% of gross loan portfolio). An allowance of AZN 1 thousands (2011 – AZN 1,350 thousands) was recognized against these loans.

Loans have been extended to the following types of customers:

| | ***31 December 2012*** | ***31 December 2011*** |
|---|---|---|
| Private companies | 44,809 | 41,003 |
| State companies | 22,375 | 22,378 |
| Individuals | 27,034 | 15,313 |
| Individual entrepreneurs | 11,414 | 3,553 |
| **Loans to customers** | **105,632** | **82,247** |

Loans are made principally within Azerbaijan in the following industry sectors:

| | ***31 December 2012*** | ***31 December 2011*** |
|---|---|---|
| Energy | 22,144 | 33,176 |
| Construction | 42,252 | 27,690 |
| Individuals | 27,034 | 15,313 |
| Individual entrepreneurs | 11,414 | 3,553 |
| Trade and services | 2,343 | 652 |
| Agriculture and food processing | 427 | 1,826 |
| Other | 18 | 37 |
| **Loans to customers** | **105,632** | **82,247** |

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 9. Property and equipment

The movements in property and equipment were as follows:

| | *Land and buildings* | *Furniture and fixtures* | *Computers and office equipment* | *Vehicles* | *Other fixed assets* | *Leasehold improve-ments* | *Assets under construc-tion* | *Total* |
|---|---|---|---|---|---|---|---|---|
| **31 December 2010** | **180** | **2,125** | **708** | **754** | **163** | **2,050** | **132** | **6,112** |
| Additions | – | 847 | 258 | 112 | 78 | 431 | 176 | **1,902** |
| Transfers | – | – | – | – | – | (21) | 21 | **–** |
| **31 December 2011** | **180** | **2,972** | **966** | **866** | **241** | **2,460** | **329** | **8,014** |
| Additions | – | 830 | 972 | 74 | 80 | 401 | – | **2,357** |
| Disposals | – | (12) | (21) | (16) | (27) | – | – | **(76)** |
| **31 December 2012** | **180** | **3,790** | **1,917** | **924** | **294** | **2,861** | **329** | **10,295** |
| **Accumulated depreciation** | | | | | | | | |
| **31 December 2010** | **(5)** | **(495)** | **(185)** | **(170)** | **(23)** | **(480)** | **–** | **(1,358)** |
| Depreciation charge | (8) | (609) | (202) | (187) | (38) | (432) | – | **(1,476)** |
| **31 December 2011** | **(13)** | **(1,104)** | **(387)** | **(357)** | **(61)** | **(912)** | **–** | **(2,834)** |
| Depreciation charge | (8) | (821) | (281) | (216) | (55) | (514) | – | **(1,895)** |
| Disposals | – | 7 | 18 | 16 | 17 | – | – | **58** |
| **31 December 2012** | **(21)** | **(1,918)** | **(649)** | **(557)** | **(99)** | **(1,426)** | **–** | **(4,670)** |
| **Net book value:** | | | | | | | | |
| **31 December 2010** | **175** | **1,630** | **523** | **584** | **140** | **1,570** | **132** | **4,754** |
| **31 December 2011** | **167** | **1,868** | **579** | **509** | **180** | **1,548** | **329** | **5,180** |
| **31 December 2012** | **159** | **1,872** | **1,268** | **367** | **195** | **1,435** | **329** | **5,625** |

As of 31 December 2012, included in property and equipment were fully depreciated assets of AZN 77 thousands (2011: AZN 34 thousands).

## 10. Intangible assets

The movements in intangible assets were as follows:

| | *Licenses* | *Computer software* | *Total* |
|---|---|---|---|
| **Cost** | | | |
| **31 December 2010** | **154** | **71** | **225** |
| Additions | 136 | 127 | **263** |
| **31 December 2011** | **290** | **198** | **488** |
| Additions | 607 | 1,574 | **2,181** |
| **31 December 2012** | **897** | **1,772** | **2,669** |
| **Accumulated amortization** | | | |
| **31 December 2010** | **(19)** | **(8)** | **(27)** |
| Amortization charge | (16) | (18) | **(34)** |
| **31 December 2011** | **(35)** | **(26)** | **(61)** |
| Amortization charge | (138) | (54) | **(192)** |
| **31 December 2012** | **(173)** | **(81)** | **(253)** |
| **Net book value:** | | | |
| **31 December 2010** | **135** | **63** | **198** |
| **31 December 2011** | **255** | **172** | **427** |
| **31 December 2012** | **724** | **1,692** | **2,416** |

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 11. Foreclosed property

As of 31 December 2012 and 2011 foreclosed property in the amount of AZN 294 thousands are represented by two apartments which the Bank took possession of, and is in the process of selling. As of 31 December 2012 the fair value of this property equals its carrying value.

It is the Bank's policy to dispose of repossessed properties in an orderly fashion. The proceeds will be used to reduce or repay the outstanding loans. In general, the Bank does not occupy repossessed properties for business use.

## 12. Other assets and liabilities

Other assets comprise:

| | *31 December 2012* | *31 December 2011* |
|---|---|---|
| **Other financial assets** | | |
| Accrued interest receivable on guarantees and letters of credit | 180 | 109 |
| Settlements on money transfers | 41 | 5 |
| | 221 | 114 |
| **Other non-financial assets** | | |
| Prepayments for purchase of property and equipment | 772 | 655 |
| Prepayments and other debtors | 423 | 1,531 |
| Deferred expenses | 411 | 471 |
| Receivable from Ministry of Taxes | 13 | 530 |
| Other | 45 | – |
| | 1,664 | 3,187 |
| **Other assets** | **1,885** | **3,301** |

Other liabilities comprise:

| | *31 December 2012* | *31 December 2011* |
|---|---|---|
| **Other financial liabilities** | | |
| Payments in the course of settlements | 242 | 293 |
| Accrued expenses | 93 | 190 |
| Other | – | 1 |
| | 335 | 484 |
| **Other non-financial liabilities** | | |
| Deferred income | 221 | – |
| Provision for guarantees | 1 | 4 |
| | 222 | 4 |
| **Other liabilities** | **557** | **488** |

## 13. Amounts due to customers

The amounts due to customers include the following:

| | *31 December 2012* | *31 December 2011* |
|---|---|---|
| Current accounts | 107,534 | 53,503 |
| Time deposits | 39,380 | 29,322 |
| **Amounts due to customers** | **146,914** | **82,825** |
| Cash held as security against letters of credit | 16 | 3 |

As of 31 December 2012, time deposits were due to customers with effective annual interest rates of 3.0% – 17.5% (2011 – 3.0% – 17.0%) and maturing through2016 (2011: maturing through 2014).

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 13. Amounts due to customers (continued)

As of 31 December 2012, amounts due to customers AZN 99,529 thousands (2011 – AZN 47,096 thousands)were due to three (2011 – three) largest customers.These deposits comprise significant concentration of approximately 68% (2011 – 57%) of the total customer deposits portfolio.

Included in time deposits are deposits of individuals in the amount of AZN 29,602 thousands(2011 – AZN 20,342 thousands). In accordance with the Azerbaijan Civil Code, the Bank is obliged to repay such deposits upon demand of a depositor. In case a term deposit is repaid upon demand of the depositor prior to maturity, interest on it is paid based on the interest rate for demand deposits, unless a different interest rate is specified in the agreement.

Amounts due to customers include accounts with the following types of customers:

| | *31 December 2012* | *31 December 2011* |
|---|---|---|
| Private enterprises | 62,081 | 25,707 |
| State and budgetary organizations | 49,269 | 32,101 |
| Individuals | 32,638 | 24,827 |
| Employees | 2,846 | 99 |
| Individual entrepreneurs | 80 | 91 |
| **Amounts due to customers** | **146,914** | **82,825** |

An analysis of customer accounts by economic sector follows:

| | *31 December 2012* | *31 December 2011* |
|---|---|---|
| Construction | 51,461 | 16,966 |
| Energy | 49,117 | 31,265 |
| Individuals | 35,484 | 24,926 |
| Insurance | 9,872 | 8,500 |
| Trade and services | 112 | 128 |
| Individual entrepreneurs | 80 | 91 |
| Transportation and communication | 2 | 8 |
| Other | 786 | 941 |
| **Amounts due to customers** | **146,914** | **82,825** |

## 14. Amounts due to credit institutions

As of 31 December 2012 the Bank has outstanding amount due to credit institutions of nil (2011 – AZN 8,360 thousands).

## 15. Taxation

| | *Year ended 31 December 2012* | *Year ended 31 December 2012* |
|---|---|---|
| The corporate income tax expense comprises: | | |
| Current tax charge | (2,851) | (65) |
| Deferred tax charge/(credit) – origination and reversal of temporary differences (note 19) | (346) | |
| **Income tax expense** | **(3,197)** | **(65)** |

In accordance with the Law of the Republic of Azerbaijan on enhancement of the activities of banks, insurance and reinsurance companies (N710-IIIQ and dated 28 October 2008), financial institutions are exempt from payment of profit tax with effect from 1 January 2009 for a period of three consecutive years, if the current year's profit is capitalized. As a result, based on the shareholders' meeting held on 9 March 2011, the Bank decided to utilise the tax exemption in accordance with the law for the years 2009-2012.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 15. Taxation (continues)

As 31 December 2012 and 2011 the corporate income tax rate from is 20%. The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

| | *Year ended 31 December 2012* | *Year ended 31 December 2011* |
|---|---|---|
| **Profit before income tax expense** | **16,133** | **11,770** |
| Statutory tax rate | 20% | 20% |
| **Theoretical income tax expense at the statutory rate** | **(3,227)** | **(2,354)** |
| Tax-exempt income arising from capitalization of profit | – | 2,354 |
| Unrecognized deferred tax assets from prior year | 48 | – |
| Tax effect of non-deductable expense | (25) | (65) |
| Other | 7 | – |
| **Income tax expense** | **(3,197)** | **(65)** |

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

| | | *Origination and reversal of temporary differences* | | | *Origination and reversal of temporary differences* | | |
|---|---|---|---|---|---|---|---|
| | *2010* | *In the income statement* | *In other compre-hensive income* | *2011* | *In the income statement* | *In other compre-hensive income* | *2012* |
| **Tax effect of deductible temporary differences:** | | | | | | | |
| Loans to customers | – | – | – | – | 69 | – | 69 |
| Property and equipment | – | – | – | – | 215 | – | 215 |
| Intangible assets | – | – | – | – | 22 | – | 22 |
| Other liabilities | – | – | – | – | 41 | – | 41 |
| **Deferred tax assets** | **–** | **–** | **–** | **–** | **346** | **–** | **346** |
| **Tax effect of taxable temporary differences:** | | | | | | | |
| Loans to banks | – | – | – | – | (24) | – | (24) |
| Loans to customers | – | – | – | – | (285) | – | (285) |
| Provision for guarantees and letters of credit | – | – | – | – | (324) | – | (324) |
| Foreclosed property | – | – | – | – | (59) | – | (59) |
| **Deferred tax liabilities** | **–** | **–** | **–** | **–** | **(692)** | **–** | **(692)** |
| **Net deferred tax liabilities** | **–** | **–** | **–** | **–** | **(346)** | **–** | **(346)** |

## 16. Equity

In 2011 share capital was increased by AZN 15,672 thousands from AZN 51,000 thousands to AZN 66,672 thousands through capitalization of the profit earned for the year ended 31 December 2010 and additional cash contribution in amount of AZN 10,000 thousands.

In 1 June 2012, the shareholders decided to increase the share capital by AZN 11,458 thousands through capitalization of the profit earned for the year ended 31 December 2011, by AZN 667 thousands amounts reserved for increase in share capital and additional cash contribution in amount of AZN 8,600 thousands. In addition, the share capital was increased through capitalization of the part of retained earnings amounting to AZN 10 thousands. As a result the share capital was increased from AZN 66,672 thousands to AZN 87,407 thousands.

As of 31 December 2012 the number of issued and fully paid ordinary shares is 319,939 (2011 – 288,460) with a nominal value per share of AZN 0.273 thousands (2011 – AZN 0.231 thousands).

The share capital of the Bank was contributed by the shareholders in AZN and they are entitled to dividends and any capital distribution in AZN.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 17. 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.

### Taxation

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

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

As of 31 December the Bank's commitments and contingencies comprised the following:

| | *31 December 2012* | *31 December 2011* |
|---|---|---|
| **Credit related commitments** | | |
| Guarantees issued | 60,578 | 62,156 |
| Undrawn loan commitments | 20,262 | 1,437 |
| Letters of credit | 1,555 | 109 |
| | **82,396** | **63,702** |
| **Operating lease commitments** | | |
| Not later than 1 year | 669 | 638 |
| Later than 1 year but not later than 5 years | 505 | 522 |
| Later than 5 years | – | 62 |
| | **1,174** | **1,222** |
| Less – Provisions | (1) | (4) |
| **Commitments and contingencies (before deducting collateral)** | **83,569** | **64,920** |
| Less – Cash held as security against letters of credit | (16) | (3) |
| **Commitments and contingencies** | **83,553** | **64,917** |

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 17. Commitments and contingencies (continued)

Included in guarantees issued as of 31 December 2012 the Bank made available to its two (2011 – two) major customers guarantees for AZN 60,562 thousands (2011 – AZN 69,829 thousands) for the purpose of financing projects in construction industry.

### 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.

## 18. Net fee and commission income

| Net fee and commission income comprises: | *Year ended 31 December 2012* | *Year ended 31 December 2011* |
|---|---|---|
| Guarantees and letters of credit | 2,154 | 621 |
| Cash operations | 852 | 572 |
| Plastic card operations | 805 | 886 |
| Settlements operations | 513 | 488 |
| Other | – | 8 |
| **Fee and commission income** | **4,324** | **2,575** |
| Plastic card operations | (520) | (874) |
| Settlements operations | (120) | (434) |
| Other | (52) | (46) |
| **Fee and commission expense** | **(692)** | **(1,354)** |
| **Net fee and commission income** | **3,632** | **1,221** |

## 19. Personnel and general and administrative expenses

| Personnel and general and administrative expenses comprise: | *Year ended 31 December 2012* | *Year ended 31 December 2011* |
|---|---|---|
| Salaries and bonuses | (4,190) | (3,092) |
| Social security costs | (919) | (678) |
| Other | (123) | (39) |
| **Personnel expenses** | **(5,232)** | **(3,809)** |

| General and administrative expenses comprise: | *Year ended 31 December 2012* | *Year ended 31 December 2011* |
|---|---|---|
| Occupancy and rent | (788) | (600) |
| Security | (666) | (421) |
| Marketing and advertising | (362) | (251) |
| Legal and consultancy | (205) | (245) |
| Printing and office supplies | (104) | (102) |
| Communications | (332) | (73) |
| Vehicle running costs | (70) | (68)` |
| Repair and maintenance | (104) | (63) |
| Operating taxes | (55) | (51) |
| Deposit insurance fee | (60) | (32) |
| Business travel and related expenses | (55) | (47) |
| Utilities | (42) | (34) |
| Membership | (4) | (15) |
| Other | (233) | (108) |
| **General and administrative expenses** | **(3,080)** | **(2,110)** |

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 20. 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 sustainability and 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, liquidity, market and 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.

*Management Board*

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

*The Assets and Liabilities Management Committee ("ALMC")*

The ALMC is responsible for the development and implementation of strategy and tools related to all aspects of financial management of 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 Unit 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 that 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 Board of Directors.

*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 worst 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 analyze, control and identify early risks. On a regular basis detailed reporting of industry and customer risks takes place.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 20. Risk management (continued)

### Introduction (continued)

*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 risks are controlled and managed accordingly. The Bank intends to expand its position in retail sector in 2012. This expansion will be implemented through existing and new branches and sub-branches. The number of loan and deposit products is planned to be increased, along with the services offered to individuals. These efforts will be supported by active promotion in media and on the web.

### 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, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. 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. The Bank actively uses collateral to reduce its credit risks.

*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 statement of financial position 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 detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes.

*Credit quality per class of financial assets*

The credit quality of financial assets is managed by the Bank internal credit ratings. The table below shows the credit quality by class of asset for loan-related lines in the statement of financial position, based on the Bank's credit rating system. In the table below loans to banks and customers of high grade are those having a minimal level of credit risk, normally with a government guarantee or very well collateralized. Other borrowers with good financial position and good debt service are included in the standard grade. Sub-standard grade comprises loans below standard grade but not individually impaired. Investment securities of high grade are those issued by government and its agencies with very low default probability and at risk free rate.

| | | *Neither past due nor impaired* | | | | | |
|---|---|---|---|---|---|---|---|
| | ***Notes*** | ***High grade 2012*** | ***Standard grade 2012*** | ***Sub-standard grade 2012*** | ***Past due but not impaired 2012*** | ***Individually impaired 2012*** | ***Total 2012*** |
| Amounts due from credit institutions | 6 | 1,555 | 2,546 | – | – | – | **4,101** |
| Loans to banks | 7 | – | 6,000 | – | – | – | **6,000** |
| Loans to customers | 8 | | | | | | |
| Corporate lending | | 22,375 | 42,951 | – | 121 | 1,737 | **67,184** |
| Individuals lending | | – | – | – | 856 | 367 | **38,448** |
| **Total** | | **23,930** | **51,497** | **–** | **977** | **2,104** | **115,733** |

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 20. Risk management (continued)

### Credit risk (continued)

| | *Notes* | *Neither past due nor impaired* *High grade 2011* | *Standard grade 2011* | *Sub-standard grade 2011* | *Past due but not impaired 2011* | *Individually impaired 2011* | *Total 2011* |
|---|---|---|---|---|---|---|---|
| Amounts due from credit institutions | 6 | – | 1,345 | – | – | – | **1,345** |
| Loans to customers | 8 | | | | | | |
| Corporate lending | | 22,377 | 39,167 | 1,837 | – | – | **63,381** |
| Individuals lending | | – | 18,866 | – | – | – | **18,866** |
| **Total** | | **22,377** | **59,378** | **1,837** | **–** | **–** | **83,592** |

The Bank classifies its loan related assets as follows:

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

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

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

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

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

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

*Aging analysis of past due but not impaired loans per class of financial assets*

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

| | *Less than 30 days 2012* | *31 to 60 days 2012* | *61 to 90 days 2012* | *More than 90 days 2012* | *Total 2012* |
|---|---|---|---|---|---|
| Loans to customers | | | | | |
| Corporate lending | 46 | 75 | – | – | **121** |
| Individuals lending | 693 | 48 | 55 | 60 | **856** |
| **Total** | **739** | **123** | **55** | **60** | **977** |

*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.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 20. Risk management (continued)

### Credit risk(continued)

*Individually assessed allowances*

The Bank determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realizable 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 historical losses on the portfolio and expected receipts and recoveries once impaired. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

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

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

| | *31 December 2012* | | | | *31 December 2011* | | | |
|---|---|---|---|---|---|---|---|---|
| | *Azerbaijan* | *OECD* | *CIS and other countries* | *Total* | *Azerbaijan* | *OECD* | *CIS and other countries* | *Total* |
| **Assets:** | | | | | | | | |
| Cash and cash equivalents | 80,072 | 44,064 | 1,830 | **125,966** | 79,088 | 574 | 88 | **79,750** |
| Amounts due from credit institutions | 2,546 | 1,555 | – | **4,101** | 1,341 | 4 | – | **1,345** |
| Loans to banks | 6,000 | – | – | **6,000** | – | – | – | **–** |
| Loans to customers | 103,529 | – | – | **103,529** | 80,352 | – | – | **80,352** |
| Other financial assets | 221 | – | – | **221** | 114 | – | – | **114** |
| | **192,368** | **45,619** | **1,830** | **239,817** | **160,895** | **578** | **88** | **161,561** |
| **Liabilities:** | | | | | | | | |
| Amounts due to customers | 146,914 | – | – | **146,914** | 82,825 | – | – | **82,825** |
| Amounts due to credit institutions | – | – | – | **–** | 8,360 | – | – | **8,360** |
| Other financial liabilities | 335 | – | – | **335** | 448 | 35 | 1 | **484** |
| Advances from shareholders for increase in share capital | – | – | – | – | 667 | – | – | 667 |
| | **147,249** | **–** | **–** | **147,249** | **92,300** | **35** | **1** | **92,336** |
| **Net assets** | **45,119** | **45,619** | **1,830** | **92,568** | **68,595** | **543** | **87** | **69,225** |

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 20. Risk management (continued)

### Liquidity risk

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 core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. The methodology of the liquidity management tools and reports is approved by the Board of Directors of the Bank, prepared by the Assets and Liabilities Management department and reviewed on the monthly basis by Asset Liabilities Committee.

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 a cash deposit (obligatory reserve) 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 primarily on a standalone basis, based on minimum liquidity ratio of 30% established by the CBAR. As at 31 December, these ratios were as follows:

| | *31 December 2012 (%)* | *31 December 2011 (%)* |
|---|---|---|
| Instant Liquidity Ratio | 104 | 130 |

*Analysis of financial liabilities by remaining contractual maturities*

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

| ***Financial liabilities As at 31 December 2012*** | ***Less than 3 months*** | ***3 to 12 months*** | ***1 to 5 years*** | ***Over 5 years*** | ***Total*** |
|---|---|---|---|---|---|
| Amounts due to customers | 117,950 | 12,828 | 21,808 | – | **152,586** |
| Other financial liabilities | 335 | – | – | – | **335** |
| **Total undiscounted financial liabilities** | **120,039** | **10,708** | **17,792** | **–** | **148,718** |

| ***Financial liabilities As at 31 December 2011*** | ***Less than 3 months*** | ***3 to 12 months*** | ***1 to 5 years*** | ***Over 5 years*** | ***Total*** |
|---|---|---|---|---|---|
| Amounts due to customers | 55,669 | 16,268 | 13,751 | – | **85,688** |
| Amounts due to credit institutions | 8,459 | – | – | – | **8,459** |
| Other financial liabilities | 479 | – | – | 5 | **484** |
| **Total undiscounted financial liabilities** | **64,611** | **16,268** | **13,751** | **5** | **94,635** |

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

| | ***Less than 3 months*** | ***3 to 12 months*** | ***1 to 5 years*** | ***Over 5 years*** | ***Total*** |
|---|---|---|---|---|---|
| 2012 | 10,823 | 51,210 | – | – | **62,133** |
| 2011 | – | 62,265 | – | – | **62,265** |

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

The Bank does not receive any significant funds from any one organization or private individual. The maturity analysis does not exhibit any significant negative gaps in any given period.

Included in due to customers are term deposits of individuals. In accordance with the Azerbaijan legislation, the Bank is obliged to repay such deposits upon demand of a depositor. Refer to Note 12.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 20. Risk management (continued)

### 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 and foreign exchanges. The Bank does not have any significant equity, corporate fixed income or derivatives holdings.

*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 ALMC on regular basis reviews the overall interest rate spreads by detailed analysis of the assets and liabilities interest rate structure.

*Currency risk*

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

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

The tables below indicate the currencies to which the Bank had significant exposure at 31 December on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the AZN, with all other variables held constant on profit or loss (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on equity does not differ from the effect on profit or loss. A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase.

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 | 72,399 | 26,162 | 25,226 | 2,179 | 125,966 |
| Amounts due from credit institutions | 1,604 | 942 | – | 1,555 | 4,101 |
| Loans to banks | 6,000 | – | – | – | 6,000 |
| Loans to customers | 100,155 | 3,346 | 28 | – | 103,529 |
| Other financial assets | 191 | 26 | – | 4 | 221 |
| **Total financial assets** | **180,349** | **30,476** | **25,254** | **3,738** | **239,817** |
| **Financial liabilities** | | | | | |
| Amounts due to customers | 90,899 | 28,109 | 25,522 | 2,384 | 146,914 |
| Other financial liabilities | 212 | 107 | 11 | 5 | 335 |
| **Total financial liabilities** | **91,111** | **28,216** | **25,533** | **2,389** | **147,249** |
| **Net financial position** | **89,238** | **2,260** | **(279)** | **1,349** | **92,568** |

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 20. Risk management (continued)

### Market risk (continued)

*Currency risk (continued)*

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

| | AZN | USD | EUR | Other | Total 2011 |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Cash and cash equivalents | 69,620 | 8,222 | 1,824 | 84 | 79,750 |
| Amounts due from credit institutions | 830 | 515 | – | – | 1,345 |
| Loans to customers | 76,691 | 3,661 | – | – | 80,352 |
| Other financial assets | 106 | 8 | – | – | 114 |
| **Total financial assets** | **147,247** | **12,406** | **1,824** | **84** | **161,561** |
| **Financial liabilities** | | | | | |
| Amounts due to customers | 70,903 | 10,145 | 1,769 | 8 | 82,825 |
| Amounts due to credit institutions | 8,360 | – | – | – | 8,360 |
| Other financial liabilities | 435 | 46 | 3 | – | 484 |
| Advances from shareholders for increase in share capital | 667 | – | – | – | 667 |
| **Total financial liabilities** | **80,365** | **10,191** | **1,772** | **8** | **92,336** |
| **Net financial position** | **66,882** | **2,215** | **52** | **76** | **69,225** |

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

| | 31 December 2012 | | 31 December 2011 | |
|---|---|---|---|---|
| | **AZN/USD +1.85%** | **AZN/USD -1.85%** | **AZN/USD +5.09%** | **AZN/USD -5.09%** |
| Impact on profit before tax | 42 | (42) | 113 | (113) |

| | 31 December 2012 | | 31 December 2011 | |
|---|---|---|---|---|
| | **AZN/EUR +8.19%** | **AZN/EUR -8.19%** | **AZN/EUR +14.55%** | **AZN/EUR -14.55%** |
| Impact on profit before tax | (23) | (23) | 8 | (8) |

### 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 a control framework and monitoring and responding to potential risks could be effective tools to manage the risks. Controls should include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 21. Fair values of financial instruments

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

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

| | ***Carrying value 2012*** | ***Fair value 2012*** | ***Unrecog-nized gain/(loss) 2012*** | ***Carrying value 2011*** | ***Fair value 2011*** | ***Unrecog-nized gain/(loss) 2011*** |
|---|---|---|---|---|---|---|
| ***Financial assets*** | | | | | | |
| Cash and cash equivalents | 125,966 | 125,966 | – | 79,750 | 79,750 | – |
| Amounts due from credit institutions | 4,101 | 4,101 | – | 1,119 | 1,119 | – |
| Loans to banks | 6,000 | 6,000 | – | – | – | – |
| Loans to customers | 103,529 | 103,529 | – | 80,352 | 80,352 | – |
| ***Financial liabilities*** | | | | | | |
| Amounts due to customers | 146,914 | 146,914 | – | 82,825 | 82,825 | – |
| Amounts due to credit institutions | – | – | – | 8,360 | 8,360 | – |
| **Total unrecognized change in unrealized fair value** | | | **–** | | | **–** |

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

*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 and savings accounts without a specific maturity.

*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.

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 22. 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 20 “Risk management” for the Bank’s contractual undiscounted repayment obligations.

| | *31 December 2012* | | | *31 December 2011* | | |
|---|---|---|---|---|---|---|
| | *Within one year* | *More than one year* | *Total* | *Within one year* | *More than one year* | *Total* |
| Cash and cash equivalents | 125,966 | – | 125,966 | 79,750 | – | **79,750** |
| Amounts due from credit institutions | 4,101 | – | 4,101 | 1,341 | 4 | **1,345** |
| Loans to banks | 6,000 | – | 6,000 | – | – | **–** |
| Loans to customers | 33,738 | 69,791 | 103,529 | 55,225 | 25,127 | **80,352** |
| Investment securities | – | – | – | – | – | **–** |
| Property and equipment | – | 5,625 | 5,625 | – | 5,180 | **5,180** |
| Intangible assets | – | 2,416 | 2,416 | – | 427 | **427** |
| Foreclosed property | 294 | – | 294 | 294 | – | **294** |
| Other assets | 1,885 | – | 1,885 | 2,587 | 714 | **2,771** |
| **Total** | **171,984** | **77,832** | **249,816** | **139,197** | **30,922** | **170,119** |
| | | | | | | |
| Amounts due to customers | 128,310 | 18,604 | 146,914 | 59,916 | 22,909 | **82,825** |
| Amounts due to credit institutions | – | – | – | 8,360 | – | **8,360** |
| Current income tax liability | 1,486 | – | 1,486 | | | |
| Deferred income tax liabilities | 346 | – | 346 | | | |
| Other liabilities | 557 | – | 557 | 483 | 5 | **488** |
| Advances from shareholders for increase in share capital | – | – | – | – | 667 | **667** |
| **Total** | **130,699** | **18,604** | **149,303** | **68,759** | **23,581** | **92,340** |
| **Net** | **41,285** | **59,228** | **100,513** | **70,438** | **7,871** | **78,309** |

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 23. Related party disclosures

In accordance with IAS 24 *Related Party Disclosures*, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The outstanding balances of related party transactions are as follows:

| | *31 December 2012* | | | | | *31 December 2011* | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | *Share-holders* | *Entities under common control* | *Key manage-ment personnel* | *Other related parties* | *Total* | *Share-holders* | *Entities under common control* | *Key manage-ment personnel* | *Other related parties* | *Total* |
| **Loans outstanding at 1 January, gross** | **10,833** | **–** | **42** | **–** | **10,875** | **1,700** | **–** | **22** | – | **1,722** |
| Loans issued during the year | 17,977 | 42,200 | 346 | 74 | **60,597** | 68,659 | – | 80 | – | **68,739** |
| Loan repayments during the year | (28,490) | (81) | (75) | (46) | **(28,692)** | (59,610) | – | (60) | – | **(59,670)** |
| Other movements | (79) | 44 | 21 | – | **(14)** | 84 | – | – | – | **84** |
| Loans outstanding at 31 December, gross | 241 | 41,163 | 334 | **28** | **42,766** | 10,833 | – | 42 | – | **10,875** |
| Less: allowance for impairment at 31 December | (28) | (15) | (5) | - | **(48)** | (53) | – | (4) | – | **(57)** |
| **Loans outstanding at 31 December, net** | **213** | **42,148** | **329** | **28** | **42,718** | **10,780** | **–** | **38** | **–** | **10,818** |
| **Deposits at 1 January** | **–** | **–** | **172** | **–** | **172** | **–** | **–** | **229** | – | **229** |
| Deposits received during the year | – | – | 630 | 99 | **729** | – | – | 1,487 | – | **1,487** |
| Deposits repaid during the year | – | – | (27) | (39) | **(66)** | – | – | (1,546) | – | **(1,546)** |
| Other movements | – | – | 55 | 4 | **59** | – | – | 2 | – | **2** |
| **Deposits at 31 December** | **–** | **–** | **830** | **64** | **894** | **–** | **–** | **172** | **–** | **172** |
| Current accounts at 31 December | 34 | 51,798 | 23 | 27 | **51,882** | 14 | – | 19 | – | **33** |
| Commitments and guarantees issued | 17 | 55 | – | **–** | **72** | 10,000 | – | – | – | **10,000** |

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

| | *Year ended 31 December 2012* | | | | | *Year ended 31 December 2011* | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | *Share-holders* | *Entities under common control* | *Key manage-ment personnel* | *Other related parties* | *Total* | *Share-holders* | *Entities under common control* | *Key manage-ment personnel* | *Other related parties* | *Total* |
| Interest income on loans | 2,483 | 3,951 | 25 | 2 | **6,461** | 1,402 | – | 5 | **–** | **1,407** |
| Loan impairment charge | 25 | (15) | (1) | - | **9** | (45) | – | – | **–** | **(45)** |
| Interest expense on deposits | – | – | 88 | 6 | **94** | – | – | 30 | **–** | **30** |
| Fee and commission income | 463 | 1,413 | 2 | - | **1,878** | 91 | – | 2 | **–** | **93** |
| General and administrative expenses | – | – | – | – | **–** | – | – | – | **–** | **–** |

Compensation of key management personnel (2012: 4 persons; 2011: 4 persons) was comprised of the following:

| | *Year ended 31 December 2012* | *Year ended 31 December 2011* |
|---|---|---|
| Salaries and other short-term benefits | 333 | 216 |
| Social security costs | 73 | 53 |
| **Total key management personnel compensation** | **406** | **269** |

*(Thousands of Azerbaijani manats unless otherwise indicated)*

## 24. 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 CBARin supervising the Bank.

The objectives of management when managing the Bank's capital are (i) to comply with the capital requirements set by CBAR, (ii) to safeguard the Bank's ability to continue as a going concern and (iii) to maintain strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value. Compliance with capital adequacy ratios set by CBAR is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's Chief Accountant and Chairman of the Management Board. The other objectives of capital management are evaluated annually.

*CBAR capital adequacy ratio*

The CBAR requires each bank or banking group to:

a) hold the minimum level of share capital of AZN 10,000 thousands (2011: AZN 10,000 thousands);

b) maintain a ratio of total regulatory capital to risk-weighted assets (the 'total capital ratio') at or above the prescribed minimum of 12% (2011: 12%) and

c) maintain a ratio of tier 1 capital to risk-weighted assets (the 'Tier 1 capital ratio') at or above the prescribed minimum of 6% (2011: 6%).

Management believes that the Bank was in compliance with the statutory capital adequacy ratio throughout 2012.

As of 31 December 2012, the Bank's capital adequacy ratio on this basis was as follows:

| | ***31 December 2012*** | ***31 December 2012*** |
|---|---|---|
| Tier 1 capital | 87,575 | 66,604 |
| Tier 2 capital | 12,937 | 11,705 |
| Less: deductions from capital | (2,416) | (427) |
| **Total capital** | **98,097** | **77,882** |
| **Risk weighted assets** | **216,767** | **170,034** |
| Tier 1 capital adequacy ratio | 39% | 39% |
| Total capital adequacy ratio | 45% | 46% |