OJSC “Expressbank”

Financial statements

Year ended 31 December 2013

together with independent auditors’ report

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Independent auditors' report

To the Shareholders and Board of Directors of OJSC "Expressbank"

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

Management's responsibility for the financial statements

Management of the audited entity 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 the fairness of 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 whether the financial statements are free from material misstatement.

An audit involves performing audit procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The audit procedures selected depend on our 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 of the audited entity, 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.

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Opinion

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

Ernst & Young Holdings (CIS) B.V.

30 May 2014

Statement of financial position

As of 31 December 2013

(thousands of Azerbaijani manats)

	Notes	2013	2012
Assets			
Cash and cash equivalents	5	32,140	125,966
Amounts due from credit institutions	6	3,745	4,101
Loans to banks	7	2,747	6,000
Loans to customers	8	180,255	103,529
Property and equipment	9	6,244	5,625
Intangible assets	10	2,424	2,416
Foreclosed property	11	294	294
Other assets	12	5,228	1,885
Total assets		**233,077**	**249,816**
Liabilities			
Amounts due to customers	13	95,335	146,914
Amounts due to credit institutions	14	8,470	–
Current income tax liabilities		969	1,487
Deferred income tax liabilities	15	584	346
Other liabilities	12	877	557
Total liabilities		**106,235**	**149,304**
Equity	16		
Share capital		112,317	87,407
Revaluation reserve for property and equipment		323	–
Retained earnings		14,202	13,105
Total equity		**126,842**	**100,512**
Total liabilities and equity		**233,077**	**249,816**

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

30 May 2014

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

Statement of profit or loss and other comprehensive income

For the year ended 31 December 2013

(thousands of Azerbaijani manats)

	Notes	2013	2012
Interest income			
Loans to customers		27,047	21,466
Amounts due from credit institutions		237	320
Loans to banks		371	21
Investment securities available-for-sale		84	–
		27,739	**21,807**
Interest expense			
Amounts due to customers		(5,633)	(4,421)
Amounts due to credit institutions		(323)	(38)
		(5,956)	**(4,459)**
Net interest income		**21,783**	**17,348**
Provision for impairment of interest bearing assets	8	(331)	(160)
Net interest income after provision for impairment of interest bearing assets		**21,452**	**17,188**
Net fee and commission income	18	3,474	3,633
Net gains from dealing operations		4,254	5,716
Net losses from currency translation differences		(77)	(4)
Other income		5	2
Non-interest income		**7,656**	**9,347**
Personnel expenses	19	(6,929)	(5,232)
Depreciation and amortization	9,10	(2,602)	(2,087)
General and administrative expenses	19	(4,658)	(3,080)
Other impairment and provisions		(221)	(3)
Non-interest expenses		**(14,410)**	**(10,402)**
Profit before income tax expense		**14,698**	**16,133**
Income tax expense	15	(2,991)	(3,197)
Profit for the year		**11,707**	**12,936**
Other comprehensive income			
Other comprehensive income not to be reclassified to profit or loss in subsequent periods:			
Revaluation of vehicles		404	–
Income tax effect		(81)	–
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods		**323**	**–**
Other comprehensive income for the year, net of tax		**323**	**–**
Total comprehensive income for the year		**12,030**	**12,936**

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 2013

(thousands of Azerbaijani manats)

	Share capital	*Retained earnings*	*Revaluation reserve for property and equipment*	*Total*
31 December 2011	**66,672**	**11,637**	–	**78,309**
Profit for the year	–	12,936	–	12,936
Other comprehensive income for the year	–	–	–	–
Total comprehensive income for the year	–	**12,936**	–	**12,936**
Capitalization of net statutory profit for the year 2011 to share capital (Note 16)	11,458	(11,458)		–
Use of statutory retained earnings for increase in share capital (Note 16)	10	(10)	–	–
Capitalization of amount reserved for increase in share capital (Note 16)	667	–	–	667
Cash contribution for share capital increase (Note 16)	8,600	–	–	8,600
31 December 2012	**87,407**	**13,105**	–	**100,512**
Profit for the year	–	11,707	–	11,707
Other comprehensive income for the year	–	–	323	323
Total comprehensive income for the year	–	**11,707**	**323**	**12,030**
Capitalization of net statutory profit for the year 2012 to share capital (Note 16)	10,467	(10,467)	–	–
Use of statutory retained earnings for increase in share capital (Note 16)	143	(143)	–	–
Cash contribution for share capital increase (Note 16)	14,300		–	14,300
31 December 2013	**112,317**	**14,202**	**323**	**126,842**

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 2013

(thousands of Azerbaijani manats)

	Notes	*2013*	*2012*
Cash flows from operating activities			
Interest received		25,429	21,968
Interest paid		(3,979)	(4,258)
Fees and commissions received		3,504	4,254
Fees and commissions paid		(878)	(691)
Realized gains less losses from dealing in foreign currencies		4,254	5,716
Other income received		5	2
Personnel expenses paid		(6,929)	(5,232)
General and administrative expenses paid		(4,465)	(3,018)
Cash flows from operating activities before changes in operating assets and liabilities		**16,941**	**18,741**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		356	(2,916)
Loans to banks		3,253	(6,000)
Loans to customers		(74,747)	(23,505)
Other assets		(3,454)	119
Net increase/(decrease) in operating liabilities			
Amounts due to customers		(53,269)	62,613
Amounts due to credit institutions		8,183	(8,359)
Other liabilities		1,086	24
Net cash flows (used in)/from operating activities before income tax		**(101,651)**	**40,717**
Income tax paid		(3,352)	(1,209)
Net cash (used in)/from operating activities		**(105,003)**	**39,508**
Cash flows from investing activities			
Proceeds from sale and redemption of investment securities available-for-sale		–	-
Purchase of property and equipment		(2,540)	(2,340)
Acquisition of intangible assets		(285)	(972)
Net cash used in investing activities		**(2,825)**	**(3,312)**
Cash flows from financing activities			
Proceeds from issuance of share capital	16	14,300	8,600
Net cash from financing activities		**14,300**	**8,600**
Effect of exchange rates changes on cash and cash equivalents		(77)	1,420
Net (decrease)/increase in cash and cash equivalents		**(93,605)**	**46,216**
Cash and cash equivalents, beginning	5	**125,966**	**79,750**
Cash and cash equivalents, ending	5	**32,361**	**125,966**

Non-cash transactions performed by the Bank comprise the following:

	Notes	*2013*	*2012*
Capitalization of 2012 profit	16	10,467	11,458
Capitalization of 2011 retained earnings	16	143	–
Revaluation of vehicles, net of tax		323	–

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

(thousands of Azerbaijani manats)

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 5 March 2010. 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 17 branches (2012 - 15) in Baku and other cities in Azerbaijan. The Bank's registered legal address is 134C, Y.Chamanzaminli St., Ataturk Ave., Baku, AZ1130, Azerbaijan.

Starting from 7 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 for each individual in case of business failure and revocation of the CBAR banking license subject to other conditions.

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

Shareholder	***2013*** *%*	***2012*** *%*
"ADOR" LLC	42.00	42.00
"AZENCO Group" LLC	40.00	40.00
"EnerqoServis" LLC	17.69	17.64
"Avtoneqliyyatservis" LLC	0.31	0.36
Total	**100.00**	**100.00**

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

2. Basis of preparation

General

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by International Accounting Standards Board ("IASB").

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 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.

3. Summary of accounting policies

Changes in accounting policies

Revaluation of vehicles (property and equipment)

The Bank re-assessed its accounting for property and equipment with respect to measurement of certain classes of property and equipment after initial recognition. The Bank has previously measured all property and equipment using the cost model as set out in IAS 16.30, whereby after initial recognition of the asset classified as property and equipment, the asset was carried at cost less accumulated depreciation and accumulated impairment losses.

On 31 December 2013 the Bank elected to change the method of accounting for vehicles classified in property and equipment, since the Bank believes that revaluation model more effectively demonstrates the financial position of vehicles.

After initial recognition, the Bank uses the revaluation model, whereby vehicles will be measured at fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. The Bank applied the exemptions in IAS 8, which exempts this change in accounting policy from retrospective application and extensive disclosure requirements.

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

The Bank has adopted the following amended IFRS during the year.

IFRS 13 Fair Value Measurement
IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The application of IFRS 13 has not materially impacted the fair value measurements carried out by the Bank.

IFRS 13 also requires specific disclosures on fair values, some of which replace existing disclosure requirements in other standards, including IFRS 7 *Financial Instruments: Disclosures*. Some of these disclosures are specifically required for financial instruments by IAS 34.16A(j), thereby affecting the financial statement. The Bank provides these disclosures in Note 21.

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

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

IAS 1 Clarification of the Requirement for Comparative Information (amendment)
These amendments clarify the difference between voluntary additional comparative information and the minimum required comparative information. An entity must include comparative information in the related notes to the financial statements when it voluntarily provides comparative information beyond the minimum required comparative period. The amendments clarify that the opening statement of financial position, presented as a result of retrospective restatement or reclassification of items in financial statements does not have to be accompanied by comparative information in the related notes. The amendments affect presentation only and 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 recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreements, irrespective of whether they are set off in accordance with IAS 32. These amendments had no impact on the Banks' financial position or performance.

Fair value measurement

The Bank measures financial instruments, such as trading and available-for-sale securities, derivatives and non-financial assets such as investment property, at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortized cost are disclosed in Note 21.

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

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

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

(thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Fair value measurement (continued)

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

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

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

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

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. The Bank determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

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

Loans and receivables

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

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 recognised in other comprehensive income until the investment is derecognised 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 profit or loss. However, interest calculated using the effective interest method is recognised in profit or loss.

(thousands of Azerbaijani manats)

3. Summary of 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 of the Bank has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or 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 amounts due from 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 the Central bank and Government, amounts due to credit institutions, amounts due to customers and debt securities issued. After initial recognition, borrowings are subsequently measured at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the borrowings are derecognized as well as through the amortization process.

Leases

Operating – Bank as lessee

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

Measurement of financial instruments at initial recognition

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

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

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

Offsetting of financial instruments

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)

3. Summary of accounting policies (continued)

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 and loans to customers

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

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in profit or loss. 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 profit or loss and other 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 collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

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

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

Available-for-sale financial investments

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

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

(thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised 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 profit or loss. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the statement of profit or loss.

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.
The accounting treatment of such restructuring is as follows:

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

Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original or current effective interest rate.

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised 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 profit or loss.

(thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit, guarantees and acceptances. 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 the statement of profit or loss and other comprehensive income. The premium received is recognized in profit or loss on a straight-line basis over the life of the guarantee.

Taxation

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

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be 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.

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.

Following initial recognition at cost, vehicles are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Any revaluation surplus is credited to the revaluation reserve for property and equipment included in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss, in which case the increase is recognized in profit or loss. A revaluation deficit is recognized in profit or loss, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

An annual transfer from the revaluation reserve for property and equipment to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets original cost. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

(thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Property and equipment (continued)

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.

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 amortisation 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 amortised over the useful economic lives of 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

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.

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

(thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

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.

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:

	2013	*2012*
1 US dollar	0.7845 AZN	0.7850 AZN
1 Euro	1.0780 AZN	1.0377 AZN

(thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Standards and interpretations issued but not yet effective

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

Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)
These amendments are effective for annual periods beginning on or after 1 January 2014 provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. It is not expected that this amendment would be relevant to the Bank, since there is no entity in the Bank that qualifies to be an investment entity under IFRS 10.

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

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

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

4. Significant accounting judgments and estimates

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognized in the financial statements. The most significant use of judgments and estimates are as follows:

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)

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 of 31 December 2013 its interpretation of the relevant legislation is appropriate and that the Bank's tax position will be sustained.

Determination of collateral value

Management monitors market value of collateral on a regular basis. Management uses its experienced judgement or independent opinion to adjust the fair value to reflect the current circumstances. The amount and collateral required depend on the assessment of credit risk of the counterparty.

Initial recognition of related party transactions

In the normal course of business the Bank enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2013	*2012*
Cash on hand	11,359	8,047
Current accounts with the CBAR	16,867	66,090
Current accounts with other credit institutions	4,135	51,829
	32,361	**125,966**
Less: allowance for impairment	(221)	–
Cash and cash equivalents	**32,140**	**125,966**

Current accounts with other credit institutions consist of non-interest bearing correspondent account balances with resident and non–resident banks in the amount of AZN 2,422 (2012 – AZN 5,934) and AZN 1,492 (2012 – AZN 45,895), respectively.

During 2013 the Bank created 100% impairment allowance on a nostro account held with a non-resident bank due to its default.

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2013	*2012*
Obligatory reserve with the CBAR	3,660	2,542
Blocked accounts	85	1,559
Amounts due from credit institutions	**3,745**	**4,101**

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR at 3% (2012 – 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.

As of 31 December 2013 and 2012, blocked accounts represent amounts blocked in a non-resident bank related to letters of credit issued by the Bank.

(thousands of Azerbaijani manats)

7. Loans to banks

As of 31 December 2013, loans to banks include AZN 2,747 (2012 – AZN 6,000) placed with one (2012 – two) resident bank denominated in USD (2012 – denominated in AZN), maturing in June 2014, with annual effective interest rate of 10% (2012 – 6.5%).

8. Loans to customers

Loans to customers comprise:

	2013	*2012*
Corporate lending	104,783	67,179
Individuals lending	77,753	38,453
Gross loans to customers	**182,536**	**105,632**
Less: allowance for impairment	(2,281)	(2,103)
Loans to customers	**180,255**	**103,529**

Individuals lending comprises consumer loans and loans issued to individual entrepreneurs.

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

	Corporate lending 2013	*Individuals lending 2013*	*Total 2013*
At 1 January 2013	**(209)**	**(1,894)**	**(2,103)**
(Charge)/reversal for the year	(1,337)	1,006	(331)
Amounts written off	101	209	310
Recoveries	–	(157)	(157)
At 31 December 2013	**(1,445)**	**(836)**	**(2,281)**
Individual impairment	–	(60)	(60)
Collective impairment	(1,445)	(776)	(2,221)
	(1,445)	**(836)**	**(2,281)**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**–**	**60**	**60**

	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**

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2013, comprised AZN 53 (2012 – AZN 455).

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)

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 2013, the Bank had a concentration of loans represented by AZN 104,565 due from ten largest borrowers (58% of gross loan portfolio) (2012 – AZN 68,549 or 65% of gross loan portfolio). An allowance of AZN 1,322 (2012 – AZN 1) was recognized against these loans.

Loans have been extended to the following types of customers:

	2013	*2012*
Private companies	82,350	44,804
State companies	22,433	22,375
Individuals	55,917	27,039
Individual entrepreneurs	21,836	11,414
	182,536	**105,632**

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

	2013	*2012*
Construction	50,066	42,252
Individuals	55,917	27,034
Manufacturing	29,213	–
Individual entrepreneurs	21,836	11,414
Energy	21,664	22,144
Agriculture and food processing	2,639	2,343
Trade and services	346	427
Other	855	18
	182,536	**105,632**

(thousands of Azerbaijani manats)

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*
Cost								
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**
Additions	–	758	728	61	67	958	–	2,572
Effect of revaluation	–	–	–	(220)	–	–	–	(220)
Disposals	–	(43)	(86)	–	(12)	–	–	(141)
31 December 2013	**180**	**4,505**	**2,559**	**765**	**349**	**3,819**	**329**	**12,506**
Accumulated depreciation								
31 December 2011	**(13)**	**(1,104)**	**(387)**	**(357)**	**(61)**	**(912)**	**–**	**(2,834)**
Depreciation charge	(8)	(821)	(281)	(216)	(55)	(514)	–	(1,895)
Disposals	–	7	19	16	17	–	–	59
31 December 2012	**(21)**	**(1,918)**	**(649)**	**(557)**	**(99)**	**(1,426)**	**–**	**(4,670)**
Depreciation charge	(8)	(933)	(487)	(200)	(64)	(633)	–	(2,325)
Effect of revaluation	–	–	–	624	–	–	–	624
Disposals	–	40	59	–	10	–	–	109
31 December 2013	**(29)**	**(2,811)**	**(1,077)**	**(133)**	**(153)**	**(2,059)**	**–**	**(6,262)**
Net book value								
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**
31 December 2013	**151**	**1,694**	**1,482**	**632**	**196**	**1,760**	**329**	**6,244**

Revaluation of vehicles

From 31 December 2013, the Bank has changed its accounting policy for measurement of vehicles to the revaluation model.

If vehicles were measured using the cost model, the carrying amounts would be as follows:

	2013	*2012*
Cost	985	924
Accumulated depreciation	(757)	(557)
Net carrying amount	**228**	**367**

The Bank engaged an independent appraiser to determine the fair value of its vehicles. Fair value is determined by reference to market-based evidence. The date of the revaluation was 30 December 2013. More details about the fair value of vehicles are disclosed in Note 21.

Gross carrying amount of fully depreciated property and equipment is AZN 2,010 (2012 – AZN 77).

(thousands of Azerbaijani manats)

10. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Total*
Cost			
31 December 2011	**290**	**198**	**488**
Additions	607	1,574	2,181
31 December 2012	**897**	**1,772**	**2,669**
Additions	296	29	325
Disposals	–	(120)	(120)
31 December 2013	**1,193**	**1,681**	**2,874**
Accumulated amortization			
31 December 2011	**(35)**	**(26)**	**(61)**
Amortization charge	(138)	(54)	(192)
31 December 2012	**(173)**	**(80)**	**(253)**
Amortization charge	(16)	(261)	(277)
Disposal	–	80	80
31 December 2013	**(189)**	**(261)**	**(450)**
Net book value			
31 December 2011	**255**	**172**	**427**
31 December 2012	**724**	**1,692**	**2,416**
31 December 2013	**1,004**	**1,420**	**2,424**

11. Foreclosed property

As of 31 December 2013 and 2012 foreclosed property in the amount of AZN 294 is represented by two apartments which the Bank took possession of, and is in the process of selling. As of 31 December 2013 and 2012 the fair value of this property approximates 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:

	2013	*2012*
Other financial assets		
Accrued interest receivable on guarantees and letters of credit	1,028	180
Settlements on money transfers	123	41
	1,151	**221**
Other non-financial assets		
Prepayments for purchase of property and equipment	3,445	772
Deferred expenses	417	411
Prepayments and other debtors	166	423
Receivable from Ministry of Taxes	–	13
Other	49	45
	4,077	**1,664**
Other assets	**5,228**	**1,885**

Other liabilities comprise:

	2013	*2012*
Other financial liabilities		
Payments in the course of settlements	189	242
Accrued expenses	155	93
	344	**335**
Other non-financial liabilities		
Other taxes payable	326	–
Deferred income	207	221
Provision for guarantees	–	1
	533	**222**
Other liabilities	**877**	**557**

(thousands of Azerbaijani manats)

13. Amounts due to customers

The amounts due to customers include the following:

	2013	*2012*
Current accounts	39,760	107,534
Time deposits	55,575	39,380
Amounts due to customers	**95,335**	**146,914**
Cash held as security against letters of credit (Note 17)	**81**	**16**

As of 31 December 2013, time deposits were due to customers with annual interest rates of 1.0% – 18% (2012 – 3.0%-17.5%) and maturing in 2018 (2012 – maturing in 2016).

As of 31 December 2013, amounts due to customers of AZN 41,157 (43%) were due to the ten largest customers (2012 – AZN 107,651 (73%)).

Included in time deposits are deposits of individuals in the amount of AZN 41,136 (2012 – AZN 29,602). 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:

	2013	*2012*
Individuals	45,746	32,638
State and budgetary organizations	29,544	49,269
Private enterprises	15,998	62,081
Employees	3,947	2,846
Individual entrepreneurs	100	80
Amounts due to customers	**95,335**	**146,914**

An analysis of customer accounts by economic sector follows:

	2013	*2012*
Individuals	49,693	35,484
Energy	29,884	49,117
Insurance	14,288	9,872
Trade and services	885	112
Individual entrepreneurs	100	80
Construction	1	51,461
Transportation and communication	–	2
Other	484	786
Amounts due to customers	**95,335**	**146,914**

14. Amounts due to credit institutions

As of 31 December 2013 amounts due to credit institutions includes the following:

	2013	*2012*
Current accounts	5	–
Time deposits	3,729	–
Loan from bank	3,001	–
Amounts due to Azerbaijan Mortgage Fund	1,735	–
Amounts due to credit institutions	**8,470**	**–**

During 2013, the Bank attracted deposits from two non-resident commercial banks (2012 – nil) comprising AZN 3,729 (2012 – nil) maturing through July 2014 to June 2015 and with annual interest rates of 10.0%-11.63% p.a.

As of 31 December 2013, loan from bank represents a loan borrowed from a resident commercial bank in the amount of AZN 3,001 (2012 – nil) maturing on 28 January 2014, with the annual interest rate of 5.5% p.a.

As of 31 December 2013, the Bank had loans borrowed from Azerbaijan Mortgage Fund amounting to AZN 1,735 (2012 – nil), maturing through September 2043 and bearing annual interest rates of 1%-4% p.a.

(thousands of Azerbaijani manats)

15. Taxation

The corporate income tax expense comprises:

	2013	*2012*
Current tax charge)	(2,834)	(2,851)
Deferred tax credit/(charge) – origination and reversal of temporary differences	(238)	(346)
Less: deferred tax recognised in other comprehensive income	81	–
Income tax expense	**(2,991)**	**(3,197)**

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

	2013	*2012*
Revaluation of vehicles	81	–
Income tax charged to other comprehensive income	**81**	**–**

As of 31 December 2013 and 2012, the corporate income tax rate 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:

	2013	*2012*
Profit before income tax expense	**14,697**	**16,133**
Statutory tax rate	20%	20%
Theoretical income tax expense at the statutory rate	**(2,939)**	**(3,227)**
Unrecognized deferred tax assets from prior year	–	48
Tax effect of non-deductible expense	(49)	(25)
Other	(3)	7
Income tax expense	**(2,991)**	**(3,197)**

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*		
	2011	*In the income statement*	*In other compre-hensive income*	*2012*	*In the income statement*	*In other compre-hensive income*	*2013*
Tax effect of deductible temporary differences:							
Cash and cash equivalents	–	–	–	–	45	–	45
Loans to customers	–	69	–	69	76	–	145
Property and equipment	–	215	–	215	164	(81)	298
Intangible assets	–	22	–	22	(6)	–	16
Other liabilities	–	40	–	40	19	–	59
Deferred tax assets	**–**	**346**	**–**	**346**	**298**	**(81)**	**563**
Tax effect of taxable temporary differences:							
Loans to banks	–	(24)	–	(24)	13	–	(11)
Loans to customers	–	(285)	–	(285)	(461)	–	(746)
Provision for guarantees and letters of credit	–	(324)	–	(324)	21	–	(303)
Foreclosed property	–	(59)	–	(59)	–	–	(59)
Other liabilities	–	–	–	–	(28)	–	(28)
Deferred tax liabilities	**–**	**(692)**	**–**	**(692)**	**(455)**	**–**	**(1,147)**
Net deferred tax liabilities	**–**	**(346)**	**–**	**(346)**	**(157)**	**(81)**	**(584)**

(thousands of Azerbaijani manats)

16. Equity

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

In December 28, 2012 the shareholders of the Bank have decided to increase share capital of the Bank by additional cash contribution in the amount of AZN 14,300 that was paid on 30 April 2013. This increase was carried out by issuance of additional 52,343 shares with par value of AZN 0.273. In June 28, 2013 the shareholders decided to capitalize its 2012 statutory profit in the amount of AZN 10,467 and retained earnings of 2011 in the amount of AZN 143. As a result the share capital was increased from AZN 87,407 to AZN 112,317.

As of 31 December 2013 the number of issued and fully paid ordinary shares is 372,282 (2012 – 319,939) with a nominal value per share of AZN 0.302 (2012 – AZN 0.273).

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.

Revaluation reserve for property and equipment

The revaluation reserve for property and equipment is used to record increases in the fair value of vehicles and decreases to the extent that such decrease relates to an increase on the same asset previously recognized in equity.

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 Azerbaijan 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 preceding the year of review.

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

(thousands of Azerbaijani manats)

17. Commitments and contingencies (continued)

Compliance with CBAR ratios

The CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As of 31 December 2013, the Bank was in compliance with these ratios except for ratios of a) maximum credit exposure of a bank per a single borrower or a group of connected borrowers that should not exceed 7 percent of the bank's total capital when the market value of the security of credit exposures is less than 100 percent of such credit exposures, or the market value of real estate collateral of loans is below 150% of the loan value and b) loans issued to related party entities and entities acting on behalf of the latter that should not exceed 20 percent of the bank's total capital. As of 31 December 2013, the Bank's ratios were 118.18% and 124.73% respectively.

As a result of this non-compliance the Bank provided to CBAR an action plan on how these breaches are going to be rectified. The plan contains a complete list of measures that would rectify current breach and will bring the Bank into compliance with the CBAR statutory requirement.

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

	2013	*2012*
Credit related commitments		
Guarantees issued	53,199	60,578
Undrawn loan commitments	23,335	20,262
Letters of credit	81	1,555
	76,615	**82,395**
Operating lease commitments		
Not later than 1 year	1,173	669
Later than 1 year but not later than 5 years	1,633	505
	2,806	**1,174**
Less – Provisions	–	(1)
Commitments and contingencies (before deducting collateral)	**79,421**	**83,568**
Less – Cash held as security against letters of credit	(81)	(16)
Commitments and contingencies	**79,340**	**83,552**

Included in guarantees issued as of 31 December 2013 the Bank made available to its one (2012 – two) major customer guarantees for AZN 53,199 (2012 – AZN 60,562) 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:

	2013	*2012*
Cash operations	1,451	852
Guarantees and letters of credit	1,381	2,154
Plastic card operations	1,048	805
Settlements operations	471	514
Other	1	–
Fee and commission income	**4,352**	**4,325**
Plastic card operations	(509)	(520)
Cash operations	(188)	–
Settlements operations	(123)	(120)
Other	(58)	(52)
Fee and commission expense	**(878)**	**(692)**
Net fee and commission income	**3,474**	**3,633**

(thousands of Azerbaijani manats)

19. Personnel and general and administrative expenses

Personnel and general and administrative expenses comprise:

	2013	*2012*
Salaries and bonuses	(5,519)	(4,190)
Social security costs	(1,210)	(919)
Other	(200)	(123)
Personnel expenses	**(6,929)**	**(5,232)**

General and administrative expenses comprise:

	2013	*2012*
Occupancy and rent	(1,262)	(788)
Security	(779)	(666)
Marketing and advertising	(758)	(362)
Communications	(434)	(332)
Computer software costs	(362)	–
Legal and consultancy	(185)	(205)
Repair and maintenance	(153)	(104)
Printing and office supplies	(127)	(104)
Vehicle running costs	(80)	(70)
Operating taxes	(71)	(55)
Deposit insurance fee	(70)	(60)
Business travel and related expenses	(65)	(55)
Utilities	(51)	(42)
Membership	(15)	(4)
Other	(246)	(233)
General and administrative expenses	**(4,658)**	**(3,080)**

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.

(thousands of Azerbaijani manats)

20. Risk management (continued)

Introduction (continued)

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.

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 2014. 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.

(thousands of Azerbaijani manats)

20. Risk management (continued)

Credit risk (continued)

Credit-related commitments risks

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

		Neither past due nor impaired					
2013	***Notes***	***High grade***	***Standard grade***	***Sub-standard grade***	***Past due but not impaired***	***Individually impaired***	***Total***
Amounts due from credit institutions	6	–	3,745	–	–	–	3,745
Loans to banks	7	–	2,747	–	–	–	2,747
Loans to customers	8						
Corporate lending		–	30,206	23,197	51,380	–	104,783
Individuals lending		757	74,375	343	2,218	60	77,753
Total		**757**	**111,073**	**23,540**	**53,598**	**60**	**189,028**

		Neither past due nor impaired					
2012	***Notes***	***High grade***	***Standard grade***	***Sub-standard grade***	***Past due but not impaired***	***Individually impaired***	***Total***
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		–	37,224	–	857	367	38,448
Total		**23,930**	**88,721**	**–**	**978**	**2,104**	**115,733**

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.

(thousands of Azerbaijani manats)

20. Risk management (continued)

Credit risk (continued)

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

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.

2013	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
Loans to customers					
Corporate lending	11,715	–	–	39,665	51,380
Individuals lending	1,620	135	101	362	2,218
Total	**13,335**	**135**	**101**	**40,027**	**53,598**

2012	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
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.

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan on an individual basis. After the selection of significant loans the Bank evaluates the collaterals, payment history, clients' creditworthiness and defines if the loan is impaired or not. Not impaired loans are evaluated according to collective assessment procedures. Loans with impairment indicators are assessed individually. Recoverable amount of impaired loans are calculated by discounting of fair value of collaterals.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans 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.

(thousands of Azerbaijani manats)

20. Risk management (continued)

Credit risk (continued)

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

	2013				*2012*			
	Azerbaijan	*OECD*	*CIS and other countries*	*Total*	*Azerbaijan*	*OECD*	*CIS and other countries*	*Total*
Assets:								
Cash and cash equivalents	30,648	1,071	421	32,140	80,072	44,064	1,830	125,966
Amounts due from credit institutions	3,664	81	–	3,745	2,546	1,555	–	4,101
Loans to banks	2,747	–	–	2,747	6,000	–	–	6,000
Loans to customers	180,255	–	–	180,255	103,529	–	–	103,529
Other financial assets	1,089	–	62	1,151	221	–	–	221
	218,403	**1,152**	**483**	**220,038**	**192,368**	**45,619**	**1,830**	**239,817**
Liabilities:								
Amounts due to customers	95,335	–	–	95,335	146,914	–	–	146,914
Amounts due to credit institutions	4,741	3,402	327	8,470	–	–	–	–
Other financial liabilities	341	–	3	344	335	–	–	335
	100,417	**3,402**	**330**	**104,149**	**147,249**	**–**	**–**	**147,249**
Net assets	**117,986**	**(2,250)**	**153**	**115,889**	**45,119**	**45,619**	**1,830**	**92,568**

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged 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:

	2013 (%)	*2012 (%)*
Instant Liquidity Ratio (assets receivable or realizable within one day/ liabilities repayable on demand)	68	104

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.

As at 31 December 2013	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to customers	43,484	26,630	31,655	–	101,769
Amounts due to credit institutions	3,043	425	4,378	1,722	9,568
Other financial liabilities	344	–	–	–	344
Total undiscounted financial liabilities	46,871	27,055	36,033	1,722	111,681

(thousands of Azerbaijani manats)

20. Risk management (continued)

Liquidity risk and funding management (continued)

As at 31 December 2012	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to customers	117,950	12,828	21,808	–	152,586
Amounts due to credit institutions	–	–	–	–	–
Other financial liabilities	335	–	–	–	335
Total undiscounted financial liabilities	**118,285**	**12,828**	**21,808**	**–**	**152,921**

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*
2013	24,358	52,179	78	–	**76,615**
2012	31,185	51,210	–	–	**82,395**

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 13.

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. As of 31 December 2013 and 2012, the Bank does not have any financial assets and liabilities with floating interest rate.

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 the statement of 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 the statement of profit or loss. A negative amount in the table reflects a potential net reduction in statement of profit or loss or equity, while a positive amount reflects a net potential increase.

(thousands of Azerbaijani manats)

20. Risk management (continued)

Market risk (continued)

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

	2013		*2012*	
	AZN/USD +1.37%	**AZN/USD -1.37%**	**AZN/USD +1.85%**	**AZN/USD -1.85%**
Impact on profit before tax	81	(81)	42	(42)

	2013		*2012*	
	AZN/EUR +10.16%	**AZN/EUR -10.16%**	**AZN/EUR +8.19%**	**AZN/EUR -8.19%**
Impact on profit before tax	(4)	4	(23)	23

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.

21. Fair values of financial instruments

Fair value hierarchy

		Fair value measurement using			
2013	*Date of valuation*	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
Property and equipment – vehicles	31-Dec-2013	–	–	632	**632**
Assets for which fair values are disclosed					
Cash and cash equivalents	31-Dec-2013	32,140	–	–	**32,140**
Amounts due from credit institutions	31-Dec-2013	–	–	3,745	**3,745**
Loans to banks	31-Dec-2013	–	–	2,747	**2,747**
Loans to customers	31-Dec-2013	–	–	180,255	**180,255**
Liabilities for which fair values are disclosed					
Amounts due to customers	31-Dec-2013	–	–	95,335	**95,335**
Amounts due to credit institutions	31-Dec-2013	–	–	8,470	**8,470**

(thousands of Azerbaijani manats)

21. Fair values of financial instruments (continued)

Fair value hierarchy (continued)

2012	Date of valuation	Fair value measurement using: Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets for which fair values are disclosed					
Cash and cash equivalents	31-Dec-2012	125,966	–	–	**125,966**
Amounts due from credit institutions	31-Dec-2012	–	–	4,101	**4,101**
Loans to banks	31-Dec-2012	–	–	6,000	**6,000**
Loans to customers	31-Dec-2012	–	–	103,529	**103,529**
Liabilities for which fair values are disclosed					
Amounts due to customers	31-Dec-2012	–	–	146,914	**146,914**

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 2013	Fair value 2013	Unrecognized gain/(loss) 2013	Carrying value 2012	Fair value 2012	Unrecognized gain/(loss) 2012
Financial assets						
Cash and cash equivalents	32,140	32,140	–	125,966	125,966	–
Amounts due from credit institutions	3,745	3,745	–	4,101	4,101	–
Loans to banks	2,747	2,747	–	6,000	6,000	–
Loans to customers	180,255	179,494	(761)	103,529	103,529	–
Financial liabilities						
Amounts due to customers	95,335	95,335	–	146,914	146,914	–
Amounts due to credit institutions	8,470	8,470	–	–	–	–
Total unrecognized change in unrealized fair value			**(761)**			**–**

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.

Financial assets and financial liabilities carried at amortized cost

Fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to the CBAR and credit institutions and other financial assets and liabilities is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

Property and equipment – vehicles

Fair value of the vehicles was determined by using market comparable method. This means that valuations performed by the valuer are based on market transaction prices, adjusted for difference in the nature, location or condition of the specific property. As of the date of revaluation, 31 December 2013, the properties' fair values are based on valuations performed by "Real Prays" company – an accredited independent valuer.

(thousands of Azerbaijani manats)

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.

	2013			*2012*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	32,140	–	32,140	125,966	–	125,966
Amounts due from credit institutions	3,741	4	3,745	4,101	–	4,101
Loans to banks	2,747	–	2,747	6,000	–	6,000
Loans to customers	151,064	29,191	180,255	33,738	69,791	103,529
Property and equipment	–	6,244	6,244	–	5,625	5,625
Intangible assets	–	2,424	2,424	–	2,416	2,416
Foreclosed property	294	–	294	294	–	294
Other assets	5,086	142	5,228	1,885	–	1,885
Total	**195,072**	**38,005**	**233,077**	**171,984**	**77,832**	**249,816**
Amounts due to customers	68,082	27,253	95,335	128,310	18,604	146,914
Amounts due to credit institutions	3,333	5,137	8,470	–	–	–
Current income tax liability	969	–	969	1,487	–	1,487
Deferred income tax liabilities	–	131	131	346	–	346
Other liabilities	877	–	877	557	–	557
Total	**73,261**	**32,521**	**105,782**	**130,700**	**18,604**	**149,304**
Net	**121,811**	**5,484**	**127,295**	**41,284**	**59,228**	**100,512**

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:

	2013					*2012*				
	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	**241**	**42,163**	**334**	**28**	**42,766**	**10,833**	**–**	**42**	**–**	**10,875**
Loans issued during the year	800	44,496	256	37	45,589	17,977	42,200	346	74	60,597
Loan repayments during the year	(235)	(11,774)	(142)	(57)	(12,208)	(28,490)	(81)	(75)	(46)	(28,692)
Other movements	5	2,651	8	–	2,664	(79)	44	21	–	(14)
Loans outstanding at 31 December, gross	**811**	**77,536**	**456**	**8**	**78,811**	**241**	**42,163**	**334**	**28**	**42,766**
Less: allowance for impairment at 31 December	(96)	(1)	(6)	–	(103)	(28)	(15)	(5)	–	(48)
Loans outstanding at 31 December, net	**715**	**77,535**	**450**	**8**	**78,708**	**213**	**42,148**	**329**	**28**	**42,718**
Deposits at 1 January	**–**	**–**	**830**	**64**	**894**	**–**	**–**	**172**	**–**	**172**
Deposits received during the year	–	–	162	195	357	–	–	630	99	729
Deposits repaid during the year	–	–	(270)	(134)	(404)	–	–	(27)	(39)	(66)
Other movements	–	–	70	(4)	66	–	–	55	4	59
Deposits at 31 December	**–**	**–**	**792**	**121**	**913**	**–**	**–**	**830**	**64**	**894**
Current accounts at 31 December	**7**	**273**	**15**	**35**	**330**	**34**	**51,798**	**23**	**27**	**51,882**
Commitments and guarantees issued	16,400	54,043	106	14	70,563	17	55	–	–	72

(thousands of Azerbaijani manats)

23. Related party disclosures (continued)

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

	Year ended 31 December 2013					*Year ended 31 December 2012*				
	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	60	10,955	46	3	**11,064**	2,483	3,951	25	2	**6,461**
Loan impairment charge	(68)	14	(1)	–	**(55)**	25	(15)	(1)	–	**9**
Interest expense on deposits	–	–	103	20	**123**	–	–	88	6	**94**
Fee and commission income	41	2,249	–	–	**2,290**	463	1,413	2	–	**1,878**
General and administrative expenses	–	–	–	–	**–**	–	–	–	–	**–**

Compensation of key management personnel (2013: 4 persons; 2012: 4 persons) was comprised of the following:

	2013	*2012*
Salaries and other short-term benefits	449	333
Social security costs	87	73
Total key management personnel compensation	**536**	**406**

24. Capital adequacy

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.

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

The CBAR requires each bank or banking group to: (a) hold the minimum level of share capital of AZN 10,000 (2012 – AZN 10,000); (b) maintain a ratio of total regulatory capital to the risk-weighted assets (the 'total capital ratio') at or above the prescribed minimum of 12% (2012 – 12%) and (c) maintain a ratio of tier 1 capital to the risk-weighted assets (the 'Tier 1 capital ratio') at or above the prescribed minimum of 6% (2012 – 6%).

Management believes that the Bank was in compliance with the statutory capital adequacy ratio throughout 2013.

As of 31 December 2013 and 2012, the Bank's capital adequacy ratio on this basis was as follows:

	2013	*2012*
Tier 1 capital	112,326	87,575
Tier 2 capital	13,525	12,937
Less: deductions from capital	(2,424)	(2,416)
Total capital	**123,427**	**98,096**
Risk weighted assets	**271,598**	**216,767**
Tier 1 capital adequacy ratio	40%	39%
Total capital adequacy ratio	45%	45%