Bank VTB (Azerbaijan) OJSC

Financial statements

Year ended 31 December 2014
together with Independent auditors' report

Contents

Building a better working world

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

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

Independent auditors' report

To the Shareholders and Board of Directors of Bank VTB (Azerbaijan) OJSC

We have audited the accompanying financial statements of Bank VTB (Azerbaijan) OJSC, which comprise the statement of financial position as of 31 December 2014, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

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

Auditors' responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Bank VTB (Azerbaijan) OJSC as of 31 December 2014, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young Holdings (CIS) B.V.

06 April 2015

Statement of financial position

As of 31 December 2014

(Amounts presented are in thousands of Azerbaijani Manats)

	Notes	*2014*	*2013*
Assets			
Cash and cash equivalents	5	8,423	9,277
Mandatory reserves with Central Bank of the Republic of Azerbaijan		4,026	4,197
Amounts due from credit institutions	6	305	5,029
Loans to customers	7	269,341	184,113
Property and equipment		3,128	1,879
Intangible assets		1,284	1,223
Deferred income tax assets	8	–	1,144
Other assets	9	3,361	459
Total assets		**289,868**	**207,321**
Liabilities			
Amounts due to credit institutions	10	207,572	126,554
Amounts due to customers	11	25,818	31,250
Deferred tax liability	8	281	–
Other liabilities	9	1,500	765
Subordinated debts	12	5,402	4,378
Total liabilities		**240,573**	**162,947**
Equity			
Share capital	13	50,815	50,815
Accumulated deficit		(1,520)	(6,441)
Total equity		**49,295**	**44,374**
Total liabilities and equity		**289,868**	**207,321**

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

Yuri Yakovlev Chairman of the Management Board

Ilgar Novruzov Chief Financial Officer

Ravilya Sharafetdinova Chief Accountant

06 April 2015

Bank VTB (Azərbaycan) Açıq Səhmdar Cəmiyyəti
VTB Bank (Azerbaijan) Open Joint-Stock Company
VTB
Bakı, Azərbaycan Respublikası
Baku, Republic of Azerbaijan

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

Statement of profit or loss and other comprehensive income

For the year ended 31 December 2014

(Amounts presented are in thousands of Azerbaijani Manats)

	Notes	2014	2013
Interest income		36,361	20,264
Interest expense		(10,159)	(5,717)
Net interest income	15	**26,202**	**14,547**
Impairment charge on interest bearing assets	6, 7	(7,426)	(2,394)
Net interest income after impairment charge on interest bearing assets		**18,776**	**12,153**
Fee and commission income	16	1,447	950
Fee and commission expense	16	(167)	(184)
Net gain from foreign currencies:			
- dealing differences, net		315	250
- translation differences, net		282	2
Other income		646	457
Net non-interest income		**2,523**	**1,475**
Operating income		**21,299**	**13,628**
Operating expenses	17	(14,953)	(10,233)
Profit before income tax expense		**6,346**	**3,395**
Income tax (expense)/benefit	8	(1,425)	1,144
Net profit for the year		**4,921**	**4,539**
Other comprehensive income for the year		–	–
Total comprehensive income for the year		**4,921**	**4,539**

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

Statement of changes in equity

For the year ended 31 December 2014

(Amounts presented are in thousands of Azerbaijani Manats)

	Notes	Share capital	Accumulated deficit	Total equity
31 December 2012		**23,815**	**(10,980)**	**12,835**
Total comprehensive income for the year		–	4,539	4,539
Issue of share capital	13	27,000	–	27,000
31 December 2013		**50,815**	**(6,441)**	**44,374**
Total comprehensive income for the year		–	4,921	4,921
31 December 2014		**50,815**	**(1,520)**	**49,295**

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

Statement of cash flows

For the year ended 31 December 2014

(Amounts presented are in thousands of Azerbaijani Manats)

	Notes	*2014*	*2013*
Cash flows from operating activities			
Interest received		36,070	18,019
Interest paid		(9,913)	(4,931)
Fees and commissions received		1,447	952
Fees and commissions paid		(167)	(184)
Realised gains less losses from dealing in foreign currencies		315	250
Other operating income received		646	398
Personnel expenses paid		(9,360)	(6,442)
Other operating expenses paid		(3,845)	(2,388)
Cash flows from operating activities before changes in operating assets and liabilities		**15,193**	**5,674**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		4,749	(1,304)
Mandatory reserves with the Central Bank of the Republic of Azerbaijan		171	(2,859)
Loans to customers		(100,860)	(112,275)
Other assets		54	(46)
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		87,914	72,087
Customer accounts		(5,183)	16,872
Other liabilities		121	79
Net cash from/(used in) operating activities before income tax		**2,159**	**(21,772)**
Income tax paid		–	–
Net cash from/(used in) operating activities		**2,159**	**(21,772)**
Cash flows from investing activities			
Purchase of property and equipment		(3,199)	(1,309)
Purchase of intangible assets		(316)	(236)
Net cash used in investing activities		**(3,515)**	**(1,545)**
Cash flows from financing activities			
Proceeds from issuance of new equity shares		–	27,000
Proceeds from subordinated debts		1,113	–
Net cash from financing activities		**1,113**	**27,000**
Effect of exchange rates changes on cash and cash equivalents		(611)	65
Net increase in cash and cash equivalents		**(854)**	**3,748**
Cash and cash equivalents, beginning		**9,277**	**5,529**
Cash and cash equivalents, ending	5	**8,423**	**9,277**

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

1. Principal activities

Bank VTB (Azerbaijan) Open Joint Stock Company (the "Bank") was formed as "AF-Bank" OJSC on 14 December 1993 under the laws of the Republic of Azerbaijan. The Bank operates under a general banking license under registration number 162 issued by the Central Bank of the Republic of Azerbaijan ("CBAR") on 22 October 1993.

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.

The Bank participates in the state deposit insurance scheme, which was introduced by the Azeri Law, "Insurance of individual deposits in the Republic of Azerbaijan" dated 29 December 2006. Insurance covers Bank's liabilities to individual depositors for the amount up to 30 thousands of Azerbaijani Manats for each individual in case of business failure and revocation of the CBAR banking license.

On 27 October 2007 two companies registered in Cyprus Balmwell Limited LLC and Nies Ventures Limited LLC acquired 99.8% of the Bank from its former shareholders. On 31 July 2008 and on 9 November 2009, "Bank VTB" OJSC (Russian Federation) (The Parent) and "Ata Holding" OJSC acquired 51% and 48.99% of the Bank, respectively, from Nies Ventures Limited LLC and Balmwell Limited LLC.

The Bank has 13 branches (2013 – 5 branches) within the Republic of Azerbaijan. The Bank had 457 employees as of 31 December 2014 (2013 – 274).

The Bank's registered legal address is 38, Khatai Avenue, Baku, the Republic of Azerbaijan.

As of 31 December 2014 and 2013 the following shareholders owned the share capital of the Bank:

	2014	*2013*
	%	%
Shareholder		
Bank VTB OJSC (Russian Federation)	51.00	51.00
Ata Holding OJSC	48.99	48.99
Kamilov Ashraf	0.01	0.01
Total	**100.00**	**100.00**

As at the date of these financial statements; the ultimate controlling party of the Bank is the government of the Russian Federation through Bank VTB OJSC (Russian Federation).

2. Basis of preparation

General

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below.

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

Presentation of financial statements

The Bank presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the statement of financial position date (current) and more than 12 months after the statement of financial position date (non-current) is presented in Note 18.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

3. Summary of accounting policies

Changes in accounting policies

The accounting policies adopted in the preparation of the financial statements as at December 31, 2014 are consistent with those followed in the preparation of the financial statements of the prior year, except for the adoption of new standards and amendments to standards, including any consequential amendments to other standards summarized below. The Bank has adopted the following amended IFRS an IFRIC which are effective for annual periods beginning on or after 1 January 2014:

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 amendments had no impact on the Bank's financial position.

IFRIC Interpretation 21 Levies (IFRIC 21)

IFRIC 21 clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. This IFRIC had no impact on the Bank's financial statements as it has applied the recognition principles under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* consistent with the requirements of IFRIC 21.

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 had no impact on the Bank's financial position.

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

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

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.

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.

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

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Fair value measurement (continued)

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 recognized 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.

Held-to-maturity investments

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

Loans to customers

Loans and advances to customers are recorded when the Bank advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates and has no intention of trading the receivable. Loans and advances to customers are carried at amortized cost, less allowance for impairment. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The losses arising from impairment are recognized in the income statement in "impairment charge on interest bearing assets".

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Financial assets (continued)

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.

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.

Mandatory reserves with the Central Bank of the Republic of Azerbaijan

Mandatory cash balances in AZN and foreign currency held with the CBAR are carried at amortized cost and represent non-interest bearing mandatory reserve deposits, which are not available to finance the Bank's day-to-day operations, and hence are not considered as part of cash and cash equivalents for the purpose of the statement of cash flows.

Derivative financial instruments

In the normal course of business, the Bank enters into various derivative financial instruments including, forwards, swaps and options in the foreign exchange. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the statement of profit or loss comprehensive income as net gains / (losses) from trading securities or net gains / (losses) from foreign currencies dealing, depending on the nature of the instrument.

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair on the trading portfolio with changes in fair value recognised in profit or loss.

Borrowings

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

Operating leases – Bank as lessee

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

3. Summary of accounting policies (continued)

Measurement of financial instruments at initial recognition

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

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

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

Impairment of financial assets

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation 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 amortised 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, recognised 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 recognised 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 realised 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 recognised, the previously recognised 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.

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

Amounts due from credit institutions and loans to customers (continued)

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

Held-to-maturity financial investments

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

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

Available-for-sale financial investments

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

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition coast and the current fair value, less any impairment loss on that investment previously recognised in the 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 profit or loss and other comprehensive income.

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

Renegotiated loans

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

The accounting treatment of such restructuring is as follows:

- If the currency of the loan has been changed the old loan is derecognised and the new loan is recognized;
- 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.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

Renegotiated loans (continued)

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 "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 recognised 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 derecognised 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 recognised in profit or loss and other comprehensive income.

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 recognised 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 amortised 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. The premium received is recognised in profit or loss and other comprehensive income on a straight-line basis over the life of the guarantee.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Taxation

The current income tax expense is calculated in accordance with regulations of the Republic of Azerbaijan.

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

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

There are also has various operating taxes, that are assessed on the Bank's activities. These taxes are included as a component of other operating 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.

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

	Percentage
Leasehold improvements	33%
Computer equipment	25%
Furniture and fixtures	25%
Motor vehicles	25%
Other property and equipment	20%

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 other operating expenses, unless they qualify for capitalization.

Intangible assets

Intangible assets include computer software and licenses. Intangible assets acquired separately are measured on initial recognition at cost. 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 3 to 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 recognised when the Bank has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of obligation can be made.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Repossessed collateral

Repossessed collateral represents financial and non-financial assets acquired by the Bank in settlement of overdue loans. The assets initially recognised at fair value when acquired and included in other financial assets or non-financial assets within other assets depending on their nature.

Repossessed collaterals are measured at the lower of their previous carrying amount and fair value less costs to sell.

Share capital

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

Dividends

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

Contingencies

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

Recognition of income and expenses

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

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

Fee and commission income

The Bank earns fee and commission income from a diverse range of services it provides to its customers.

- *Fee income earned from services that are provided over a certain period of time*

  Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income for provision of the following services: expert services and commission charged on issuance of certain mortgage loans. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognized as an adjustment to the effective interest rate on the loan.

- *Fee income from providing transaction services*

  Fees include commission income for provision of the following services: cash withdrawals, consulting, settlement operations and fees charged for transactions with plastic cards and etc. These fees or components of fees are linked to a certain performance are recognized after fulfilling the corresponding criteria.

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 recognised in the statement of profit or loss and other comprehensive income as net gain/ (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 net gain / (losses) from foreign currencies-dealing. The official CBAR exchange rates at 31 December 2014 and 31 December 2013 were as follows:

	31 December 2014	*31 December 2013*
USD/AZN	0.7844	0.7845
EUR/AZN	0.9522	1.078
RUR/AZN	0.0133	0.0241

Standards and interpretations issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below. The Bank intends to adopt these standards, if applicable, when they become effective

IFRS 9 Financial Instruments- Final Standard

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before 1 February 2015. The adoption of IFRS 9 will have an effect on the classification and measurement of the Bank's financial assets, but no impact on the classification and measurement of the Bank's financial liabilities.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Revenue arising from lease contracts within the scope of IAS 17 *Leases*, insurance contracts within the scope of IFRS 4 *Insurance Contracts* and financial instruments and other contractual rights and obligations within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* (or IFRS 9 *Financial Instruments*, if early adopted) is out of IFRS 15 scope and is dealt by respective standards.

Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recognising revenue.

The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2017 with early adoption permitted. The Bank is currently assessing the impact of IFRS 15 and plans to adopt the new standard on the required effective date.

IFRS 14 Regulatory Deferral Accounts

IFRS 14 is an optional standard that allows an entity, whose activities are subject to rate-regulation, to continue applying most of its existing accounting policies for regulatory deferral account balances upon its first-time adoption of IFRS. Entities that adopt IFRS 14 must present the regulatory deferral accounts as separate line items on the statement of financial position and present movements in these account balances as separate line items in the statement of profit or loss and other comprehensive income. The standard requires disclosures on the nature of, and risks associated with, the entity's rate-regulation and the effects of that rate-regulation on its financial statements. IFRS 14 is effective for annual periods beginning on or after 1 January 2016. Since the Bank is an existing IFRS preparer, this standard would not apply.

Amendments to IAS 19 Defined Benefit Plans: Employee Contributions

IAS 19 requires an entity to consider contributions from employees or third parties when accounting for defined benefit plans. Where the contributions are linked to service, they should be attributed to periods of service as a negative benefit. These amendments clarify that, if the amount of the contributions is independent of the number of years of service, an entity is permitted to recognise such contributions as a reduction in the service cost in the period in which the service is rendered, instead of allocating the contributions to the periods of service. This amendment is effective for annual periods beginning on or after 1 July 2014. It is not expected that this amendment would be relevant to the Bank , since defined benefit plans with contributions from employees or third parties.

Amendments to IFRS 11 Joint Arrangements: Accounting for Acquisitions of Interests

The amendments to IFRS 11 require that a joint operator accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business must apply the relevant IFRS 3 principles for business combinations accounting. The amendments also clarify that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation while joint control is retained. In addition, a scope exclusion has been added to IFRS 11 to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party.

The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation and are prospectively effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact to the Bank.

Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation

The amendments clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets. The amendments are effective prospectively for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact to the Bank given that the Bank has not used a revenue-based method to depreciate its non-current assets.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

3. Summary of accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

Amendments to IAS 16 and IAS 41 Agriculture: Bearer Plants

The amendments change the accounting requirements for biological assets that meet the definition of bearer plants. Under the amendments, biological assets that meet the definition of bearer plants will no longer be within the scope of IAS 41. Instead, IAS 16 will apply. After initial recognition, bearer plants will be measured under IAS 16 at accumulated cost (before maturity) and using either the cost model or revaluation model (after maturity). The amendments also require that produce that grows on bearer plants will remain in the scope of IAS 41 measured at fair value less costs to sell. For government grants related to bearer plants, IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* will apply. The amendments are retrospectively effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact to the Bank as the Bank does not have any bearer plants.

Amendments to IAS 27: Equity Method in Separate Financial Statements

The amendments will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying IFRS and electing to change to the equity method in its separate financial statements will have to apply that change retrospectively. For first-time adopters of IFRS electing to use the equity method in its separate financial statements, they will be required to apply this method from the date of transition to IFRS. The amendments are effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments will not have any impact on the Bank's financial statements.

4. Significant accounting judgments and estimates

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.
Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. These disclosures supplement the commentary significant accounting policies (Note 2) and financial risk management (Note 18).
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 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 amount of allowance for loan impairment recognized in the statement of financial position at 31 December 2014 was AZN 11,668 (2013 – AZN 4,233). More details are provided in Note 7.

Management monitors market value of collateral on a regular basis. Management uses its experienced judgment and 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.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

4. Significant accounting judgments and estimates (continued)

Deferred tax assets

Deferred income tax assets are recorded to the extent that realization of the related tax benefit is probable. The future taxable profits and the amount of tax benefits that are probable in the future are based on medium term business plan prepared by management and extrapolated results thereafter. The business plans are based on management expectations that are believed to be reasonable under the circumstances.

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. Judgment 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 judgment 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:

	2014	*2013*
Cash on hand	3,425	2,400
Current accounts with the Central Bank of the Republic of Azerbaijan	1,798	574
Current accounts with other banks	3,200	6,303
Cash and cash equivalents	**8,423**	**9,277**

Current accounts with other banks consist of non–interest bearing correspondent account balances with resident and non–resident banks in the amount of AZN 78 (2013 – AZN 81) and AZN 3,122 (2013 – AZN 6,222), respectively.

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2014	*2013*
Loans to banks	1,131	5,888
Other amounts	45	29
	1,176	**5,917**
Less: allowance for impairment	(871)	(888)
Amounts due from credit institutions	**305**	**5,029**

As of 31 December 2014 inter-bank loans include AZN 1,131 (2013 – AZN 5,888) placed with two (2013 – two) resident banks with an average effective annual interest rate of 12% p.a. (2013 – 7% p.a.).

Other amounts represent blocked accounts placed to secure settlement operations and security against guarantees.

The movements in allowance for impairment charge on amounts due from credit institutions were as follows:

	2014	*2013*
1 January	**888**	**981**
Charge	5	–
(Recovery)	(22)	(93)
31 December	**871**	**888**

As of 31 December 2013 the Bank placed AZN 888 in interbank loan with one of local commercial banks with effective annual interest rate of 10% p.a. The loan was fully impaired at the end of the prior reporting period. During current reporting period AZN 22 was repaid, therefore loan balance and allowance respectively decreased.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

7. Loans to customers

Loans to customers comprise:

	2014	*2013*
Auto lending	60,532	73,417
Small business lending	96,222	60,595
Corporate lending	56,871	40,214
Consumer lending	67,384	14,120
Gross loans to customers	**281,009**	**188,346**
Less: allowance for impairment	(11,668)	(4,233)
Loans to customers	**269,341**	**184,113**

In accordance with the Bank's internal classification, individual entrepreneurs with annual turnover above certain threshold established by management are also included in the corporate lending portfolio of the Bank.

Allowance for impairment of loans to customers

The movement in allowance for impairment losses on loans to customers by class of loan is as follows:

	Auto lending 2014	*Corporate lending* 2014	*Small business lending* 2014	*Consumer lending* 2014	*Total* 2014
At 1 January 2014	1,494	1,323	647	769	4,233
Charge for the year	4,090	1,397	(125)	2,073	7,435
At 31 December 2014	**5,584**	**2,720**	**522**	**2,842**	**11,668**
Individual impairment	129	1,560	285	526	2,500
Collective impairment	5,455	1,160	237	2,316	9,168
	5,584	**2,720**	**522**	**2,842**	**11,668**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**129**	**5,549**	**708**	**526**	**6,912**

	Auto lending 2013	*Corporate lending 2013*	*Small business lending 2013*	*Consumer lending 2013*	*Total 2013*
At 1 January 2013	370	1,254	118	47	1,789
Charge for the year	1,124	69	529	722	2,444
At 31 December 2013	**1,494**	**1,323**	**647**	**769**	**4,233**
Individual impairment	52	625	635	–	1,312
Collective impairment	1,442	698	12	769	2,921
	1,494	**1,323**	**647**	**769**	**4,233**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**52**	**908**	**1,676**	**-**	**2,636**

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2014, comprised AZN 975 (2013 – AZN 118).

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.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

7. 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, charges over real estate and trade receivables, third party guarantees;
- For consumer lending, cash, charges over credited consumer appliances, third party guarantees and mortgages over residential properties;
- For auto lending, cash, liens over vehicles and third party guarantees.

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 2014, the Bank had a concentration of loans represented by AZN 33,533 due from ten (2013 – ten) largest third party borrowers (12% of gross loan portfolio) (2013 – AZN 26,972 or 14% of gross loan portfolio). An allowance of AZN 945 (2013 – AZN 1,322) was recognized against these loans.

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

	2014	*2013*
Individuals	135,000	97,013
Trading enterprises	43,525	27,874
Services	36,879	20,391
Manufacturing	21,386	10,115
Other	17,618	15,093
Transport	16,568	10,272
Agriculture and food processing	5,468	4,988
Construction	3,965	–
Credit institutions, other than banks	–	1,479
Energy	600	1,121
Gross loans to customers	**281,009**	**188,346**

8. Taxation

Azerbaijan legal entities have to file individual corporate income tax declarations. Standard corporate income tax rate for companies (including banks) comprised 20% for 2014 and 2013.

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:

	2014	*2013*
Profit before tax	**6,346**	**3,397**
Statutory tax rate	20%	20%
Theoretical income tax charge at the statutory rate	**(1,269)**	**(679)**
Tax effect of permanent differences	(213)	(301)
Tax losses carried forward, not recognized previously	–	2,099
Other	57	25
Income tax (expense)/benefit	**(1,425)**	**1,144**

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

8. Taxation (continued)

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

	2012	*Origination and reversal of temporary differences in statement of profit or loss and other comprehensive income*	*2013*	*Origination and reversal of temporary differences in statement of profit or loss and other comprehensive income*	*2014*
Tax effect of deductible temporary differences:					
Other liabilities	17	99	116	136	252
Tax losses carried forward	2,099	(755)	1,344	(1,249)	95
Property and equipment	28	(28)	–	–	–
Deferred tax assets	**2,144**	**(684)**	**1,460**	**(1,113)**	**347**
Loans to customers	(157)	(113)	(270)	(194)	(464)
Property and equipment	–	–	–	(55)	(55)
Intangible assets	(16)	2	(14)	6	(8)
Amounts due from credit institutions	(22)	2	(20)	14	(6)
Other assets	(7)	(5)	(12)	(83)	(95)
Deferred tax liabilities	**(202)**	**(114)**	**(316)**	**(312)**	**(628)**
Unrecognized deferred tax asset	(1,942)	1,942	–	–	–
Net deferred income tax assets/ (liabilities)	**–**	**1,144**	**1,144**	**(1,425)**	**(281)**

9. Other assets and liabilities

Other assets comprise:

	2014	*2013*
Amounts in the course of settlement	13	15
Other receivables	250	87
Total other financial assets	**263**	**102**
Prepayment for purchase of property, equipment and intangible assets	1,205	159
Other prepayments	315	133
Repossessed collateral	1,552	–
Other non-financial assets	26	65
Total other non-financial assets	**3,098**	**357**
Other assets	**3,361**	**459**

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

9. Other assets and liabilities (continued)

Other liabilities comprise:

	2014	*2013*
Payable for professional services	176	55
Other financial liabilities	48	10
Total other financial liabilities	**224**	**65**
Payable to employees	983	468
Taxes payable, other than income tax	259	115
Other non-financial liabilities	34	117
Total other non-financial liabilities	**1,276**	**700**
Other liabilities	**1,500**	**765**

10. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2014	*2013*
Current accounts	1,649	88
Short term loans from banks	60,130	18,285
Long term loans from banks	145,793	108,181
Amounts due to credit institutions	**207,572**	**126,554**

Included in current accounts is a balance of AZN 77 (2013 – AZN 79) with "Bank VTB" OJSC (the "Parent").

As of 31 December 2014, the Bank had short term loan borrowings from the Parent and four resident banks with total principal amount of AZN 45,730 (2013 – AZN 10,102) and AZN 14,138 (2013 – AZN 7,845), respectively. Borrowings are denominated in USD, RUR and AZN with average annual interest rate of 5.4% p.a., 11% p.a. and 9.4% p.a. (2013 – 4.3% p.a.), respectively.

At of 31 December 2014, the Bank had long term borrowings from the Parent with total principal amount of AZN 144,731 (2013 – AZN 101,354). Borrowings are denominated in USD and RUR with average annual interest rate of 5.5% p.a. and 11% p.a. (2013 – 5.2% p.a.), respectively. Borrowings are maturing in 2019-2021 years

11. Amounts due to customers

The amounts due to customers include the following:

	2014	*2013*
Current accounts	7,408	17,283
Time deposits	18,410	13,967
Amounts due to customers	**25,818**	**31,250**

As of 31 December 2014, customer accounts of AZN 15,305 or 59% (2013 – AZN 19,677 or 63%) were due to the ten (2013 – ten) largest customers.

The average annual interest rate on term deposits of individual customers outstanding as of 31 December 2014 comprised 10% p.a. (2013 – 8.5% p.a.), while the average annual interest rate on term deposits of legal entities outstanding as of 31 December 2014 was 7.7% p.a. (2013 – 7.8% p.a.).

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

11. Amounts due to customers (continued)

An analysis of customer accounts by economic sector is as follows:

	2014	*2013*
Individuals	11,629	11,335
Insurance	10,142	8,354
Trading	1,958	8
Service	1,093	9,950
Credit institutions	856	1,426
Public organizations	76	91
Other	64	86
Amounts due to customers	**25,818**	**31,250**

12. Subordinated debts

As of 31 December 2014, the Bank had four (2013 – three) subordinated debts received from the Parent for principal amount of AZN 5,376 (2013 – AZN 4,354) with interest rate of 9.3% p.a. in USD and 16% p.a. in RUR (2013 – 7.16% p.a. in USD) and maturing in 2019-2021 (2013 – maturing in 2018).

Interest payables on debts are on quarterly basis and the principal payables are on the maturity dates. In the event of bankruptcy or liquidation of the Bank the repayments of this debt is subordinated to repayment of the Bank's liabilities to all other creditors.

13. Equity

As of 31 December 2014 and 2013 the number of authorized, issued and fully paid ordinary shares was 254,075,000 with a nominal value per share of AZN 0.2.

On 13 August 2013, the shareholders of the Bank increased the share capital of the Bank by additional cash contribution amounting of AZN 13,770 thousands. Increase was carried out by issuing of 68,850,000 authorized shares with par value of AZN 0.2.

On 15 November 2013, the shareholders of the Bank increased the share capital of the Bank by additional cash contribution amounting of AZN 13,230 thousands. Increase was carried out by issuing of 66,149,993 authorized shares with par value of AZN 0.2.

In accordance with Azerbaijan legislation, the shareholders of the Bank should have the following rights: elect and be elected to its management and executive bodies, collect information related to the activity of the Bank, familiarize with annual reports and accounts once a year, request holding the General Meeting of Shareholders, request amendments to the agenda of the General Meeting of Shareholders of the Bank, request audit of the activity of the Bank and in case of termination of Bank's activity, receive a distribution of Bank's assets remained after settlements with creditors and payment of calculated but unpaid dividends.

14. Commitments and contingencies

Operating environment

Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks as required by the market economy. The future stability of the Azerbaijan economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

Considering significant drop in crude oil prices during second half of 2014, there continues to be uncertainty regarding economic growth, access to capital and cost of capital, which could negatively affect the Bank's future financial position, results of operations and business prospects. In addition, as described in Note 23, Azerbaijani Manat has been devalued against major currencies by approximately 34% on 21 February 2015.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

14. Commitments and contingencies (continued)

While management believes it is taking appropriate measures to support the sustainability of the Bank's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Bank's results and financial position in a manner not currently determinable.

Legal

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

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes 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 Republic of Azerbaijan suggest that the tax authorities may be taking a more assertive position in their interpretation and application of this legislation and assessments. It is therefore possible that transactions and activities of the Bank that have not been challenged in the past may be challenged at any time in the future. As a result, significant additional taxes, penalties and interest may be assessed by the relevant authorities. Fiscal periods remain open and subject to review by the tax authorities for a period of three calendar years immediately preceding the year in which the decision to conduct a tax review is taken. The last tax audit of the Bank was completed in 2010 and covered the period from 2008 to 2010.

Management believes that as of 31 December 2014 its interpretation of the relevant legislation is appropriate and that the Bank's tax positions will be sustained.

Commitments and contingencies

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

	2014	*2013*
Credit related commitments		
Guarantees	2,489	2,570
Letters of credit	–	374
Undrawn loan commitments	12,974	10,839
	15,463	**13,783**
Capital expenditure commitments	410	258
Commitments and contingencies (before deducting collateral)	**15,873**	**14,041**
Less: provisions	(32)	(44)
Commitments and contingencies	**15,841**	**13,997**

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

15. Net interest income

Net interest income comprises:

	2014	*2013*
Interest income on loans to customers	36,224	20,023
Interest income on due from credit institutions	137	241
Interest income on financial assets recorded at amortized cost	**36,361**	**20,264**
Interest expense on due to credit institutions	(8,886)	(4,830)
Interest expense on customer accounts	(1,273)	(887)
Interest expense on financial liabilities recorded at amortized cost	**(10,159)**	**(5,717)**
Net interest income	**26,202**	**14,547**

16. Fee and commission income and expense

Fee and commission income and expense comprises:

	2014	*2013*
Cash operations	873	605
Documentary operations	106	117
Settlements operations	76	60
Plastic card operations	188	106
Other	204	62
Fee and commission income	**1,447**	**950**
Plastic card operations	(107)	(81)
Communication operations	–	(4)
Cash operations	(18)	(46)
Settlements operations	(20)	(16)
Documentary operations	(22)	(34)
Securities operations	–	(3)
Fee and commission expense	**(167)**	**(184)**
Net fee and commission income	**1,280**	**766**

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

17. Operating expenses

Operating expenses comprise:

	2014	*2013*
Salaries and bonuses	(7,958)	(5,507)
Social security costs	(1,768)	(1,219)
Other employment expenses	(254)	(163)
Personnel expenses	**(9,980)**	**(6,889)**
Depreciation and amortization	(1,159)	(932)
Occupancy and rent	(1,473)	(893)
Repair and maintenance of property and equipment	(173)	(96)
Communications	(355)	(215)
Marketing and advertising	(301)	(182)
Office supplies	(239)	(137)
Business travel and related	(161)	(122)
Representation	(105)	(122)
Legal and consultancy	(208)	(106)
Operating taxes	(161)	(90)
Security	(185)	(89)
Software cost	(214)	(189)
Utilities	(55)	(21)
Other expenses	(184)	(150)
Other operating expenses	**(4,973)**	**(3,344)**
Total operating expenses	**(14,953)**	**(10,233)**

18. Risk management

Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk 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.

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.

18. Risk management (continued)

Introduction (continued)

Risk Management

The Risk Management Unit is responsible for implementing and maintaining risk related procedures to ensure an independent control process. Also Risk Management Unit is responsible for monitoring compliance with risk principles, policies and limits, across the Bank.

Risk Controlling

The Risk Controlling Unit is responsible for monitoring compliance with risk principles, policies and limits, across the Bank. Each business group has a decentralized unit which is responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This unit also ensures the complete capture of the risks in risk measurement and reporting systems

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 Audit Committee.

Risk measurement and reporting systems

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs 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.

Risk mitigation

As part of its overall risk management, the Bank uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions.

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.

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.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

18. Risk management (continued)

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.

Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the statement of financial position.

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 before the effect of mitigation through the use of master netting and collateral agreements, is best represented by their carrying amounts.

Where financial instruments are recorded at fair value, the carrying value represents 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. The effect of collateral and other risk mitigation techniques is shown in Note 7.

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					
	Notes	***High grade 2014***	***Standard grade 2014***	***Sub-standard grade 2014***	***Past due but not impaired 2014***	***Individually impaired 2014***	***Total 2014***
Amounts due from credit institutions	6	–	310	–	–	866	1,176
Loans to customers Auto lending	7	–	–	47,630	12,773	129	60,532
Corporate lending		–	43,735	–	7,587	5,549	56,871
Small business lending		–	86,530	–	8,984	708	96,222
Consumer lending		–	–	62,058	4,800	526	67,384
Total gross balances		–	**130,575**	**109,688**	**34,144**	**7,778**	**282,185**

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

18. Risk management (continued)

Credit risk (continued)

		Neither past due nor impaired					
	Notes	*High grade 2013*	*Standard grade 2013*	*Sub-standard grade 2013*	*Past due but not impaired 2013*	*Individually impaired 2013*	*Total 2013*
Amounts due from credit institutions	6	–	5,029	–	–	888	5,917
Loans to customers Auto lending	7	–	–	66,448	6,917	52	73,417
Corporate lending		–	37,583	–	1,723	908	40,214
Small business lending		–	58,174	–	745	1,676	60,595
Consumer lending		–	–	12,705	1,415	–	14,120
Total gross balances		–	**100,786**	**79,153**	**10,800**	**3,524**	**194,263**

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 no 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 no 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 no changes in the terms and conditions of loan agreements and overdue in principal and interest.

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business 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.

An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

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

Loans to customers:

	Less than 30 days 2014	*31 to 60 days 2014*	*61 to 90 days 2014*	*More than 90 days 2014*	*Total 2014*
Auto lending	4,372	1,308	894	6,199	12,773
Corporate lending	7,415	172	–	–	7,587
Small business lending	3,386	3,160	593	1,845	8,984
Consumer lending	2,106	472	322	1,900	4,800
Total	**17,279**	**5,112**	**1,809**	**9,944**	**34,144**

	Less than 30 days 2013	*31 to 60 days 2013*	*61 to 90 days 2013*	*More than 90 days 2013*	*Total 2013*
Auto lending	3,518	1,115	617	1,667	6,917
Corporate lending	353	–	1,370	–	1,723
Small business lending	203	133	392	17	745
Consumer lending	552	63	115	685	1,415
Total	**4,626**	**1,311**	**2,494**	**2,369**	**10,800**

See Note 7 for more detailed information with respect to the allowance for impairment of loans to customers.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

18. Risk management (continued)

Credit risk (continued)

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans to customers that are not individually significant and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the appropriate delay between the time a loss is likely to have been uncured and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. The impairment allowance is reviewed by credit management to ensure alignment with the Bank's overall policy.

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

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

	2014				*2013*			
	Azerbaijan	*OECD*	*CIS and other foreign banks*	*Total*	*Azerbaijan*	*OECD*	*CIS and other foreign banks*	*Total*
Assets								
Cash and cash equivalents	5,302	134	2,987	8,423	3,055	2,409	3,813	9,277
Mandatory reserve with the CBAR	4,026	–	–	4,026	4,197	–	–	4,197
Amounts due from credit institutions	270	35	–	305	5,009	20	–	5,029
Loans to customers	269,341	–	–	269,341	184,113	–	–	184,113
Other assets	258	5	–	263	92	10	–	102
	279,197	**174**	**2,987**	**282,358**	**196,466**	**2,439**	**3,813**	**202,718**
Liabilities								
Amounts due to credit institutions	(15,714)	–	(191,858)	(207,572)	(9)	–	(126,545)	(126,554)
Amounts due to customers	(25,818)	–	–	(25,818)	(31,250)	–	–	(31,250)
Subordinated loans	–	–	(5,402)	(5,402)	–	–	(4,378)	(4,378)
Other liabilities	(224)	–	–	(224)	(59)	(2)	(4)	(65)
	(41,756)	**–**	**(197,260)**	**(239,016)**	**(31,318)**	**(2)**	**(130,927)**	**(162,247)**
Net assets/(liabilities)	**237,441**	**174**	**(194,273)**	**43,342**	**165,148**	**2,437**	**(127,114)**	**40,471**

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

18. Risk management (continued)

Liquidity risk and funding management

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

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed lines of credit that it can assess to meet liquidity needs. 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 certain liquidity ratios established by the CBAR. As of 31 December, these ratios were as follows:

	2014	*2013*
Instant Liquidity Ratio	93%	95%

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 of 31 December 2014	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to credit institutions	19,118	54,188	157,247	–	230,553
Customer accounts	9,731	11,207	6,574	–	27,512
Other liabilities	224	–	–	–	224
Subordinated loans	168	436	6,623	1,359	8,586
Total undiscounted financial liabilities	**29,241**	**65,831**	**170,444**	**1,359**	**266,875**

As of 31 December 2013	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to credit institutions	8,824	29,143	102,596	–	140,563
Customer accounts	18,935	12,873	53	–	31,861
Other liabilities	65	–	–	–	65
Subordinated loans	100	306	5,933	–	6,339
Total undiscounted financial liabilities	**27,924**	**42,322**	**108,582**	**–**	**178,828**

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*
2014	200	4,942	10,321	–	15,463
2013	1,061	2,330	10,392	–	13,783

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

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

18. Risk management (continued)

Liquidity risk and funding management (continued)

The Bank's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant concentration as of 31 December 2014 of deposits from individuals and service companies that represents about 49% of total portfolio (2013 – 68%) in the period less than one year.

As of 31 December 2014 the Bank has significant financing from the Parent totaling AZN 190,461 (2013 – AZN 111,456). Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank. Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than three months in the tables above.

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

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 classifies exposures to market risk into non-trading portfolios. Non-trading positions are managed and monitored using sensitivity analysis. Except for the concentrations within foreign currency, the Bank has no significant concentration of market risk.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Management Board has set limits on positions by currency based on the CBAR regulations. Positions are monitored on a daily basis.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2014 and 2013 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 Manat, with all other variables held constant on the statement of comprehensive income (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 comprehensive income. A negative amount in the table reflects a potential net reduction in statement of comprehensive income or equity, while a positive amount reflects a net potential increase.

Currency	Increase in currency rate in % 2014	Effect on profit before tax 2014	Increase in currency rate in % 2013	Effect on profit before tax 2013
USD	35.00%	707	1.37	1
EUR	33.36%	22	10.16	8
RUR	31.50%	(736)	22.29	(99)

Currency	Decrease in currency rate in % 2014	Effect on profit before tax 2014	Decrease in currency rate in % 2013	Effect on profit before tax 2013
USD	(35.00%)	(707)	(1.37)	(1)
EUR	(33.36%)	(22)	(10.16)	(8)
RUR	(31.50%)	736	(22.29)	99

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, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

19. Fair value measurements

Fair value hierarchy

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2014	8,423	–	–	**8,423**
Amounts due from credit institutions	31 December 2014	–	–	305	**305**
Loans to customers	31 December 2014	–	–	269,093	**269,093**
Other assets	31 December 2014	–	–	263	**263**
Liabilities for which fair values are disclosed					
Amounts due to credit institutions	31 December 2014	–	–	206,540	**206,540**
Amounts due to customers	31 December 2014	–	–	25,818	**25,818**
Subordinated loans	31 December 2014	–	–	5,372	**5,372**
Other liabilities	31 December 2014	–	–	224	**224**

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 Company's financial instruments that are 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.

	2014		
	Carrying value	*Fair value*	*Unrecognized gain/(loss)*
Assets			
Cash and cash equivalents	8,423	8,423	–
Mandatory reserve with the CBAR	4,026	4,026	–
Amounts due from credit institutions	305	305	–
Loans to customers	269,341	269,093	(248)
Other assets	263	263	–
Liabilities			
Amounts due to credit institutions	207,572	206,540	1,032
Amounts due to customers	25,818	25,818	–
Subordinated loans	5,402	5,372	30
Other liabilities	224	224	–
			814

The Bank believes the amounts presented as financial assets and liabilities in the financial statements are reasonable estimates of their fair values. As of 31 December 2013 the fair value of cash and cash equivalents, amounts due from credit institutions, loans to customers and other monetary current assets and liabilities is estimated to approximate carrying value. As of 31 December 2013 the carrying value of amounts due to credit institutions, amounts due to customers and the subordinated loan approximate their fair values as their interest rates are close to the market indices.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

19. Fair value measurements (continued)

Valuation techniques and assumptions

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 the quoted notes and bonds is based on price quotations at the reporting date. The fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to the CBR and credit institutions and other financial assets and liabilities, obligations under finance leases is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

20. 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 18 "Risk management" for the Bank's contractual undiscounted repayment obligations and how management addresses the negative maturity mismatch below for within one year.

	Within one Year 2014	*More than one year* 2014	*Total* 2014	*Within one year* 2013	*More than one year* 2013	*Total* 2013
Cash and cash equivalents	8,423	–	8,423	9,277	–	9,277
Mandatory reserves with CBAR	4,026	–	4,026	4,197	–	4,197
Amounts due from credit institutions	305	–	305	5,029	–	5,029
Loans to customers	107,622	161,719	269,341	73,455	110,658	184,113
Property and equipment	–	3,128	3,128	–	1,879	1,879
Intangible assets	–	1,284	1,284	–	1,223	1,223
Deferred tax asset	–	–	–	1,144	–	1,144
Other assets	1,869	1,492	3,361	459	–	459
Total	**122,245**	**167,623**	**289,868**	**93,561**	**113,760**	**207,321**
Amounts due to credit institutions	62,842	144,730	207,572	19,886	106,668	126,554
Customer accounts	19,871	5,947	25,818	31,205	45	31,250
Other liabilities	1,500	–	1,500	765	–	765
Deferred tax liability	–	281	281	–	–	–
Subordinated debts	25	5,377	5,402	24	4,354	4,378
Total	**84,238**	**156,335**	**240,573**	**51,880**	**111,067**	**162,947**
Net	**38,007**	**11,288**	**49,295**	**41,681**	**2,693**	**44,374**

21. 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.

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

21. Related party disclosures (continued)

The outstanding balances of related party transactions are as follows:

	2014			2013		
	Parent	*Entities under common control*	*Other related parties*	*Parent*	*Entities under common control*	*Other related parties*
Loans outstanding at 1 January, gross	**–**	**–**	**201**	**–**	**–**	**–**
Loans issued during the year	–	–	231	–	–	257
Loan repayments during the year	–	–	(243)	–	–	(57)
Other movements	–	–	1	–	–	1
Loans outstanding at 31 December, gross	**–**	**–**	**190**	**–**	**–**	**201**
Deposits at 1 January	**–**	**1,508**	**301**	**–**	**1,205**	**–**
Deposits received during the year	–	3,592	271	–	1,500	355
Deposits repaid during the year	–	(1,508)	(301)	–	(1,205)	(59)
Other movements	–	28	11	–	8	5
Deposits at 31 December	**–**	**3,620**	**282**	**–**	**1,508**	**301**
Current accounts at 31 December	**–**	**64**	**18**	**–**	**73**	**57**
Cash and cash equivalents	2,913	129	–	3,754	2,406	–
Amounts due from credit institutions	–	35	–	–	20	–
Amounts due to credit institutions	191,858	–	–	112,222	–	–
Subordinated debts	5,402	–	–	4,378	–	–
Commitments and guarantees issued	–	20	–	–	20	–

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

	For the year ended 31 December					
	2014			2013		
	Parent	*Entities under common control*	*Other related parties*	*Parent*	*Entities under common control*	*Other related parties*
Interest income	–	–	44	–	–	37
Interest expense	(8,039)	(169)	(10)	(3,736)	(56)	(7)
Fee and commission income	101	–	–	–	91	–
Fee and commission expense	(4)	–	–	(2)	–	–
Other operating expenses	–	–	(75)	–	(63)	–

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

21. Related party disclosures (continued)

Compensation of key management personnel was comprised of the following:

	2014	*2013*
Salaries and other short-term benefits	1,011	1,135
Social security costs	212	250
Total key management personnel compensation	**1,223**	**1,385**

As of 31 December 2014, key management personnel of the Bank consisted of 3 members (2013 – 5 members).

22. 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 Chairman of the Management Board and Chief Accountant. 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 AZN 50,000 (2011 – 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% (2013 – 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% (2013 – 6%).

Management believes that the Bank was in compliance with the statutory capital adequacy ratio throughout 2014 and 2013.

According to the CBAR board's decision dated 25 July 2012, the minimum total capital of existing banks and authorised capital of newly established banks increased from the current AZN 10,000 to AZN 50,000. The new requirement for the capitalisation of the existing banks came into force from January 1, 2015.

At 31 December the Bank's capital adequacy ratios based on the CBAR requirements were as follows:

	2014	*2013*
Tier 1 capital	40,558	38,362
Tier 2 capital	11,723	8,320
Less: deductions from capital	(2,074)	(1,923)
Total regulatory capital	**50,207**	**44,759**
Risk-weighted assets	**292,849**	**211,279**
Tier 1 capital adequacy ratio	13.1%	17.2%
Total capital adequacy ratio	17.1%	21.2%

23. Events after the reporting period

On 21 February 2015, Azerbaijani Manat has been devalued against US dollar and other major currencies by 34%. The exchange rates before and after devaluation were AZN 0.786 and AZN 1.050 to USD 1, respectively. This event could adversely affect the Bank's future results and financial position, including quality of the loan portfolio and tighter credit conditions. Management believes it is taking all necessary measures to support the sustainability and development of the Bank's business in the foreseeable future.