“Bank VTB (Azerbaijan)” OJSC

Financial Statements

Year ended 31 December 2012
Together with Independent Auditors’ Report

Ernst & Young

ERNST & YOUNG

Statement of financial position

As at 31 December 2012

(Thousands of Azerbaijani Manats)

	Notes	2012	2011
Assets			
Cash and cash equivalents	5	5,529	1,081
Mandatory reserves with the Central Bank of the Republic of Azerbaijan		1,336	773
Due from banks	6	3,716	485
Loans to customers	7	72,070	45,098
Property and equipment	8	932	1,345
Intangible assets	9	1,204	833
Other assets	11	706	542
Total assets		85,493	50,157
Liabilities			
Due to banks	12	53,739	26,902
Customer accounts	13	14,360	4,403
Other liabilities	11	178	358
Subordinated debts	14	4,381	3,366
Total liabilities		72,658	35,029
Equity			
Share capital	15	23,815	23,815
Accumulated deficit		(10,980)	(8,687)
Total equity		12,835	15,128
Total liabilities and equity		85,493	50,157

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

Alexander Yeryomin — Chairman of the Management Board

Ilgar Novruzov — Chief Financial Officer

Ravilya Sharafetdinova — Chief Accountant

7 March 2013

The accompanying notes on pages 6 to 33 are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 December 2012

(Thousands of Azerbaijani Manats)

	Notes	*2012*	*2011*
Interest income		7,540	4,721
Interest expense		(2,406)	(1,171)
Net interest income	17	**5,134**	**3,550**
Impairment charge on interest bearing assets	6, 7	(1,444)	(1,333)
Net interest income after impairment charge on interest bearing assets		**3,690**	**2,217**
Fee and commission income	18	629	223
Fee and commission expense	18	(163)	(60)
Net gain / (losses) from foreign currencies:			
- dealing differences, net		107	48
- translation differences, net		3	(3)
Other income		254	52
Net non-interest income		**830**	**260**
Operating income		**4,520**	**2,477**
Operating expenses	19	(6,813)	(5,563)
Loss before income tax expense		**(2,293)**	**(3,086)**
Income tax expense	10	-	-
Net loss for the year		**(2,293)**	**(3,086)**
Other comprehensive loss for the year		-	-
Total comprehensive loss for the year		**(2,293)**	**(3,086)**

The accompanying notes on pages 6 to 33 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December 2012

(Thousands of Azerbaijani Manats)

	Share capital	*Accumulated deficit*	*Total equity*
31 December 2010	**23,815**	**(5,601)**	**18,214**
Total comprehensive income for the year	-	(3,086)	(3,086)
31 December 2011	**23,815**	**(8,687)**	**15,128**
Total comprehensive income for the year	-	(2,293)	(2,293)
31 December 2012	**23,815**	**(10,980)**	**12,835**

The accompanying notes on pages 6 to 33 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2012

(Thousands of Azerbaijani Manats)

	Notes	2012	2011
Cash flows from operating activities			
Interest received		7,282	4,539
Interest paid		(1,484)	(1,130)
Fees and commissions received		629	223
Fees and commissions paid		(163)	(60)
Realised gain less losses from dealing in foreign currencies		107	48
Other operating income received		217	56
Personnel expenses paid		(4,103)	(2,685)
Other operating expenses paid		(2,036)	(1,846)
Cash flows from / (used in) operating activities before changes in operating assets and liabilities		**449**	**(855)**
Net (increase) / decrease in operating assets			
Due from banks		(4,204)	4,837
Mandatory reserves with the Central Bank of the Republic of Azerbaijan		(563)	(763)
Loans to customers		(27,185)	(32,442)
Other assets		163	(36)
Net increase / (decrease) in operating liabilities			
Due to banks		26,020	25,739
Customer accounts		9,855	631
Other liabilities		(17)	7
Net cash flows from / (used in) operating activities before income tax		**4,518**	**(2,882)**
Income tax paid		-	-
Net cash from / (used in) operating activities		**4,518**	**(2,882)**
Cash flows from investing activities			
Purchase of property and equipment		(596)	(507)
Purchase of intangible assets	9	(489)	(652)
Proceeds from available-for-sale investments		-	613
Proceeds from held-to-maturity investments, net		-	850
Net cash (used in)/from investing activities		**(1,085)**	**304**
Cash flows from financing activities			
Proceeds from subordinated debts		1,012	-
Net cash from financing activities		**1,012**	-
Effect of exchange rates changes on cash and cash equivalents		3	(4)
Net increase / (decrease) in cash and cash equivalents		**4,448**	**(2,582)**
Cash and cash equivalents, beginning		**1,081**	**3,663**
Cash and cash equivalents, ending	5	**5,529**	**1,081**

The accompanying notes on pages 6 to 33 are an integral part of these financial statements.

(Thousands of Azerbaijani Manats)

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) 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 3 branches (2011- 1 branch) within the Republic of Azerbaijan. The Bank had 180 employees as at 31 December 2012 (2011- 126).

The Bank's registered legal address is 96 Nizami Street, Baku, the Republic of Azerbaijan.

As at 31 December 2012 and 2011 the following shareholders owned the share capital of the Bank:

Shareholder	*2012* %	*2011* %
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**

The ultimate controlling party of the Bank is the government of the Russian Federation as at the date of this report 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.

Going Concern

As at 31 December 2012 the Bank had a net loss for the year ended 31 December 2012 of AZN 2,293 (2011- AZN 3,086), accumulated deficit of AZN 10,980 (2011- AZN 8,687) and negative maturity mismatch of assets and liabilities within one year (Note 22). The Bank relies on the financial support from its parent company, "Bank VTB" OJSC (Russian Federation), to enable it to continue as a going concern in the foreseeable future and to meet the requirements on capital adequacy of the Central Bank of the Republic of Azerbaijan (Note 24). Accordingly, the financial statements have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies

Changes in accounting policies

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

Amendments to IFRS 7 "Financial Instruments: Disclosures"
The Amendments were issued in October 2010 and are effective for annual periods beginning on or after 1 July 2011. The amendment requires additional disclosure about financial assets that have been transferred to enable the users of the Bank's financial statements to evaluate the risk exposures relating to those assets. The amendment affects disclosure only and has no impact on the Bank's financial position or performance.

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

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

Financial assets

Initial recognition

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

Date of recognition

All regular way purchases and sales of financial assets are recognised 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.

'Day 1' profit

Where the transaction price in a non-active market is different to the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets, the Bank immediately recognises the difference between the transaction price and fair value (a 'Day 1' profit) in the statement of comprehensive income. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognised in the statement of comprehensive income when the inputs become observable, or when the instrument is derecognised.

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 recognised in the statement of comprehensive income.

Held-to-maturity investments

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

Loans and receivables

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

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (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 comprehensive income. However, interest calculated using the effective interest method is recognised in the statement of comprehensive income.

Determination of fair value

The fair value for financial instruments traded in active market at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

Offsetting

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

Reclassification of financial assets

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

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

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

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

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the 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.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

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 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 the statement of comprehensive income.

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 due to banks, 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 the statement of comprehensive income 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.

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.

Due from banks and loans to customers

For due from banks 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 the statement of comprehensive income. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been 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 comprehensive income.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Due from banks and loans to customers (continued)

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

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

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

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 statement of comprehensive income.

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

Available-for-sale financial investments

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

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

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at 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 comprehensive income.

Renegotiated loans

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

The accounting treatment of such restructuring is as follows:

- If the currency of the loan has been changed the old loan is derecognised and the new loan is recognised.
- If the loan restructuring is not caused by the financial difficulties of the borrower the Bank uses the same approach as for financial liabilities described below.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Renegotiated loans (continued)

- If the loan restructuring is due to the financial difficulties of the borrower and the loan is impaired after restructuring, the Bank recognizes the difference between the present value of the new cash flows discounted using the original effective interest rate and the carrying amount before restructuring in the provision charges for the period. In case loan is not impaired after restructuring the Bank recalculates the effective interest rate.

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

Derecognition of financial assets and liabilities

Financial assets

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

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

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is 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 the statement of 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 comprehensive income. The premium received is recognised in the statement of comprehensive income on a straight-line basis over the life of the guarantee.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Taxation

Income taxes have been provided for in the financial statements in accordance with Azerbaijan legislation enacted or substantively enacted by the end of the reporting period.

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

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

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

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%
Computers equipment	25%
Furniture and fixtures	25%
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.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

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.

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.

Fee and commission income

The Bank earns fee and commission income from a diverse range of services it provides to its customers. These fees include commission income for provision of the following services: cash withdrawals, consulting and expert services, settlement operations, fees charged for transactions with plastic cards and etc. 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 recognised as an adjustment to the effective interest rate on the loan.

Foreign currency translation

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 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 2012 and 31 December 2011 were as follows:

	31 December 2012	31 December 2011
USD/AZN	0.7850	0.7865
EUR/AZN	1.0377	1.0178
RUR/AZN	0.0258	0.0245

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Future changes in accounting policies

Standards and interpretations issued but not yet effective

IFRS 9 "Financial Instruments"
IFRS 9, as issued, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but *Amendments to IFRS 9 mandatory Effective Date of IFRS 9 and Transition Disclosures*, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The Bank will quantify the effect of the adoption of the first phase of IFRS 9 in conjunction with the other phases, when issued, to present a comprehensive picture.

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

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

IFRS 12 Disclosure of Interests in Other Entities
IFRS 12 is effective for annual periods beginning on or after 1 January 2013. IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. In particular, the Bank will need to disclose more information about the consolidated and unconsolidated structured entities with which it is involved or which it has sponsored. However, the standard will have no impact on the Bank's financial position or performance.

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

IAS 27 Separate Financial Statements (as revised in 2011)
As a consequence of the new IFRS 10 and IFRS 12, what remains of IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The amendment becomes effective for annual periods beginning on or after 1 January 2013. The Bank expects that these amendments will have no impact on the Bank's financial position.

IAS 28 Investments in Associates and Joint Ventures (as revised in 2011)
As a consequence of the new IFRS 11 and IFRS 12. IAS 28 has been renamed IAS 28 Investments in Associates and Joint Ventures, and describes the application of the equity method to investments in joint ventures in addition to associates. The amendment becomes effective for annual periods beginning on or after 1 January 2013. The Bank expects that these amendments will have no impact on the Bank's financial position.

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

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Future changes in accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

Amendments to IAS 1 Changes to the Presentation of Other Comprehensive Income
The amendments to IAS 1 change the grouping of items presented in other comprehensive income. Items that could be reclassified (or recycled) to profit or loss at a future point in time (for example, net losses or gains on available-for-sale financial assets) would be presented separately from items that will never be reclassified (for example, revaluation of buildings). The amendment affects presentation only and has no impact on the Bank's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 July 2012.

Amendments to IFRS 7 Disclosures – Offsetting Financial assets and Financial Liabilities
These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognized financial instruments that are set off in accordance with IAS 32 Financial Instruments: Presentation. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreements, irrespective of whether they are set off in accordance with IAS 32. These amendments will not impact the Banks' financial position or performance and will become effective for annual periods beginning on or after 1 January 2013.

Amendments to IAS 32 – Offsetting Financial Assets and Financial Liabilities
These amendments clarify the meaning of "currently has a legally enforceable right to set-off". It will be necessary to assess the impact to the Bank by reviewing settlement procedures and legal documentation to ensure that offsetting is still possible in cases where it has been achieved in the past. In certain cases, offsetting may no longer be achieved. In other cases, contracts may have to be renegotiated. The requirement that the right of set-off be available for all counterparties to the netting agreement may prove to be a challenge for contracts where only one party has the right ot offset in the event of default.

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

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

Amendment to IFRS 1 – Government loans
These amendments require firs-time adopters to apply the requirements of IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, prospectively to government loans existing at the date of transition to IFRS. The amendment will have no impact on the Bank.

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

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

(Thousands of Azerbaijani Manats)

4. Significant accounting judgments and estimates

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

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.

Determination of collateral value

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

Initial recognition of related party transactions

In the normal course of business the Bank enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. 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.

Deferred tax assets

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits together with future tax planning strategies. If actual results differ from those estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected. In the event that an assessment of future utilization indicates that the carrying amount of deferred tax assets must be reduced, this reduction is recognised in the statement of comprehensive income.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2012	***2011***
Cash on hand	1,206	838
Current accounts with the Central Bank of the Republic of Azerbaijan	1,017	71
Current accounts with other banks	3,306	172
Cash and cash equivalents	**5,529**	**1,081**

Current accounts with other banks consist of non–interest bearing correspondent account balances with resident and non–resident banks in the amount of AZN 2,106 (2011 - AZN 110) and AZN 1,200 (2011 - AZN 62), respectively.

(Thousands of Azerbaijani Manats)

6. Due from banks

Due from banks comprise:

	2012	*2011*
Loans to banks	4,668	456
Other amounts	29	29
	4,697	**485**
Less – Allowance for impairment	(981)	-
Due from banks	**3,716**	**485**

As at 31 December 2012, inter-bank loans include AZN 4,668 (2011- AZN 456) placed with five (2011- one) resident banks with an average effective annual interest rate of 10% (2011- 7%).

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 banks were as follows:

	2012	*2011*
1 January	**-**	**-**
Charge	981	-
31 December	**981**	**-**

As of 31 December 2012 the Bank placed AZN 981 in interbank loan with one of local commercial banks with effective annual interest rate of 10% p.a. The loan was totally impaired at the end of the reporting period.

7. Loans to customers

Loans to customers comprise:

	2012	*2011*
Auto lending	28,609	8,416
Corporate lending	23,025	34,693
Small business lending	18,602	2,033
Consumer lending	3,623	1,282
Gross loans to customers	**73,859**	**46,424**
Less – Allowance for impairment	(1,789)	(1,326)
Loans to customers	**72,070**	**45,098**

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 2012	*Corporate lending 2012*	*Small business lending 2012*	*Consumer lending 2012*	*Total 2012*
At 1 January 2012	183	296	819	28	1,326
Charge for the year / (reversal)	187	958	(701)	19	463
At 31 December 2012	**370**	**1,254**	**118**	**47**	**1,789**
Individual impairment	176	498	115	-	789
Collective impairment	194	756	3	47	1,000
	370	**1,254**	**118**	**47**	**1,789**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**264**	**871**	**439**	**-**	**1,574**

(Thousands of Azerbaijani Manats)

7. Loans to customers (continued)

Allowance for impairment of loans to customers (continued)

	Auto lending 2011	*Corporate lending 2011*	*Small business lending 2011*	*Consumer lending 2011*	*Total 2011*
At 1 January 2011	-	900	593	-	1,493
Charge for the year / (reversal)	183	(604)	1,726	28	1,333
Amounts written off	-	-	(1,500)	-	(1,500)
At 31 December 2011	**183**	**296**	**819**	**28**	**1,326**
Individual impairment	26	181	718	-	925
Collective impairment	157	115	101	28	401
	183	**296**	**819**	**28**	**1,326**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**40**	**352**	**1,356**	**-**	**1,748**

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2012, comprised AZN 370 (2011 - AZN 228).

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.

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 at 31 December 2012, the Bank had a concentration of loans represented by AZN 20,114 due from the ten (2011 - ten) largest third party borrowers (27% of gross loan portfolio) (2011 - AZN 33,779 or 73% of gross loan portfolio). An allowance of AZN 622 (2011 - AZN 768) was recognised against these loans.

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

	2012	*2011*
Individuals	32,232	9,698
Trading enterprises	19,320	2,915
Manufacturing	4,994	28,042
Agriculture and food processing	4,955	2,033
Services	4,518	2,009
Transport	2,492	856
Credit Institutions, other than banks	1,860	-
Energy	1,490	-
Other	1,998	871
Gross loans to customers	**73,859**	**46,424**

(Thousands of Azerbaijani Manats)

8. Property and equipment

The movements in property and equipment were as follows:

	Leasehold improvements	*Computers equipment*	*Furniture and fixtures*	*Motor vehicles*	*Other property and equipment*	*Total*
Cost						
31 December 2010	**751**	**729**	**438**	**345**	**76**	**2,339**
Additions	160	80	163	-	14	417
31 December 2011	**911**	**809**	**601**	**345**	**90**	**2,756**
Additions	76	138	60	-	32	306
31 December 2012	**987**	**947**	**661**	**345**	**122**	**3,062**
Accumulated depreciation						
31 December 2010	**(250)**	**(214)**	**(130)**	**(142)**	**(18)**	**(754)**
Depreciation charge	(259)	(186)	(113)	(82)	(17)	(657)
31 December 2011	**(509)**	**(400)**	**(243)**	**(224)**	**(35)**	**(1,411)**
Depreciation charge	(293)	(202)	(147)	(56)	(21)	(719)
31 December 2012	**(802)**	**(602)**	**(390)**	**(280)**	**(56)**	**(2,130)**
Net book value:						
31 December 2010	**501**	**515**	**308**	**203**	**58**	**1,585**
31 December 2011	**402**	**409**	**358**	**121**	**55**	**1,345**
31 December 2012	**185**	**345**	**271**	**65**	**66**	**932**

9. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Total*
Cost			
31 December 2010	**44**	**417**	**461**
Additions	507	13	520
31 December 2011	**551**	**430**	**981**
Additions	104	385	489
31 December 2012	**655**	**815**	**1,470**
Accumulated amortization			
31 December 2010	**(14)**	**(61)**	**(75)**
Amortization charge	(32)	(41)	(73)
31 December 2011	**(46)**	**(102)**	**(148)**
Amortization charge	(68)	(50)	(118)
31 December 2012	**(114)**	**(152)**	**(266)**
Net book value:			
31 December 2010	**30**	**356**	**386**
31 December 2011	**505**	**328**	**833**
31 December 2012	**541**	**663**	**1,204**

(Thousands of Azerbaijani Manats)

10. Taxation

Azerbaijan legal entities have to file individual corporate income tax declarations. Standard corporate income tax rate for companies (including banks) comprised 20% for 2012 and 2011.

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:

	2012	*2011*
Loss before tax	**(2,293)**	**(3,086)**
Statutory tax rate	20%	20%
Theoretical income tax benefit at the statutory rate	**459**	**617**
Tax effect of permanent differences	14	(168)
Change in unrecognised deferred tax assets	(473)	(449)
Income tax expense	-	-

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

	2010	*Origination and reversal of temporary differences — In the statement of comprehensive income*	*2011*	*Origination and reversal of temporary differences — In the statement of comprehensive income*	*2012*
Tax effect of temporary differences:					
Tax losses carried forward	1,167	393	1,560	544	2,104
Loans to customers	(69)	(75)	(144)	(13)	(157)
Property and equipment	(4)	(4)	(8)	36	28
Intangible assets	(28)	27	(1)	(15)	(16)
Other liabilities	(13)	80	67	(50)	17
Other assets	-	-	-	(7)	(7)
Available for sale investments	(1)	1	-	-	-
Held to maturity investments	(5)	5	-	-	-
Due from banks	(22)	22	-	(22)	(22)
Net total deferred tax assets	**1,025**	**449**	**1,474**	**473**	**1,947**
Unrecognised deferred tax asset	**(1,025)**	**(449)**	**(1,474)**	**(473)**	**(1,947)**
Net deferred tax asset	-	-	-	-	-

The Bank has available AZN 10,520 of tax losses carried forwards which begin to expire in 2013, if not utilized (2011- AZN 7,801 of accumulated tax losses carried forward which begin to expire during the next five years until 2016).

11. Other assets and liabilities

Other assets comprise:

	2012	*2011*
Amounts in the course of settlement	13	43
Agency fees receivables	64	-
Total other financial assets	77	43
Prepayment for purchase of property, equipment and intangible assets	512	222
Other prepayments	69	235
Other non-financial assets	48	42
Total other non financial assets	629	499
Other assets	**706**	**542**

(Thousands of Azerbaijani Manats)

11. Other assets and liabilities (continued)

Other liabilities comprise:

	2012	*2011*
Payable for professional services	31	11
Other financial liabilities	37	1
Total other financial liabilities	68	12
Payable to employees	87	276
Taxes payable, other than income tax	21	62
Other non-financial liabilities	2	8
Total other non-financial liabilities	110	346
Other liabilities	**178**	**358**

12. Due to banks

Due to banks comprise:

	2012	*2011*
Current accounts	82	82
Short term loans from banks	19,886	26,820
Long term loans from banks	33,771	-
Due to banks	**53,739**	**26,902**

Included in current accounts is a balance of AZN 79 (2011 - AZN 79) with “Bank VTB” OJSC (the “Parent”).

At 31 December 2012, the Bank had short term loan borrowings from the Parent and one non-resident bank with total principal amount of AZN 8,915 (2011- AZN 26,820) and AZN 10,971 (2011- AZN nil), respectively. Borrowings are denominated in USD with average annual interest rate of 5.3% p.a. (2011 - 3.5% p.a.) and 5.7% p.a. (2011 - nil %), respectively.

At 31 December 2012, the Bank had long term borrowings from the Parent and one non-resident bank with total principal amount of AZN 27,936 (2011 - AZN nil) and AZN 5,835 (2011- AZN nil), respectively. Borrowings are denominated in USD with average annual interest rate of 6.4% (2011 - nil %) and 7% (2011 - nil %), respectively. Borrowings are maturing in 2014-2017 years.

13. Customer accounts

Customer accounts include the following:

	2012	*2011*
Current accounts	3,377	1,041
Time deposits	10,983	3,362
Customer accounts	**14,360**	**4,403**
Held as security against guarantees	**20**	**-**

At 31 December 2012, customer accounts of AZN 9,740 or 68% (2011- AZN 2,646 or 60%) were due to the ten (2011- six) largest customers.

The average annual interest rate on term deposits of individual customers outstanding at 31 December 2012 comprised 9.5% (2011- 8.9%), while the average annual interest rate on term deposits of legal entities outstanding at 31 December 2012 was 8.6% (2010- 9.2%).

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

	2012	*2011*
Insurance	8,795	2,363
Individuals	4,804	1,702
Service	617	74
Public organizations	53	264
Construction	4	-
Other	87	-
Customer accounts	**14,360**	**4,403**

(Thousands of Azerbaijani Manats)

14. Subordinated debts

As of 31 December 2012, the Bank had three (2011 - two) subordinated debts received from the Parent for principal amount of AZN 4,381 (2011 - AZN 3,366) with interest rate of 7.16% - 9.84% p.a. (2011 - 9.84%) and maturing in August 2018 and December 2018 (2011 - August 2018 and December 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's repayments of this debt is subordinated to repayment of the Bank's liabilities all other creditors.

15. Equity

As at 31 December 2012 and 2011 the number of authorized, issued and fully paid ordinary shares is 119,075 thousands with a nominal value per share of 0.2 AZN.

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

In accordance with Azerbaijan legislation, the shareholders of the Bank should have the following rights: participate in the management of the Bank, 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.

16. Commitments and contingencies

Operating environment

Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks. 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.

The Azerbaijani economy has been affected by the global financial crisis. Despite some indications of recovery there continues to be uncertainty regarding further 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. To the extent that information is available, the Bank has reflected revised estimates of expected future cash flows in its impairment assessment.

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 at 31 December 2012 its interpretation of the relevant legislation is appropriate and that the Bank's tax positions will be sustained.

(Thousands of Azerbaijani Manats)

16. Commitments and contingencies (continued)

Commitments and contingencies

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

	2012	*2011*
Credit related commitments		
Guarantees	1,040	1,042
Undrawn loan commitments	4,129	196
	5,169	**1,238**
Operating lease commitments		
Not later than 1 year	570	745
Later than 1 year but not later than 5 years	805	-
	1,375	745
Capital expenditure commitments	130	-
Commitments and contingencies (before deducting collateral)	**6,674**	**1,983**
Less - Cash held as security against guarantees (Note 13)	(20)	-
Commitments and contingencies	**6,654**	**1,983**

17. Net interest income

Net interest income comprises:	*2012*	*2011*
Interest income on loans to customers	6,888	4,261
Interest income on due from banks	646	419
Interest income on held to maturity investments	-	25
Interest income on financial assets recorded at amortized cost	7,534	4,705
Other interest income	6	16
Interest income on other financial assets and transactions	6	16
Interest income	**7,540**	**4,721**
Interest expense on due to banks	(1,935)	(897)
Interest expense on customer accounts	(471)	(274)
Interest expense on financial liabilities recorded at amortized cost	**(2,406)**	**(1,171)**
Net interest income	**5,134**	**3,550**

(Thousands of Azerbaijani Manats)

18. Fee and commission income and expense

Fee and commission income and expense comprises:

	2012	*2011*
Cash operations	262	99
Consulting and expert services	212	52
Documentary operations	62	1
Settlements operations	38	34
Plastic card operations	32	11
Other	23	26
Fee and commission income	**629**	**223**
Plastic card operations	(64)	(5)
Communication operations	(49)	(34)
Cash operations	(29)	(1)
Settlements operations	(11)	(14)
Documentary operations	(10)	(5)
Securities operations	-	(1)
Fee and commission expense	**(163)**	**(60)**
Net fee and commission income	**466**	**163**

19. Operating expenses

Operating expenses comprise:

	2012	*2011*
Salaries and bonuses	(3,136)	(2,482)
Social security costs	(678)	(540)
Other employment taxes	(126)	(63)
Personnel expenses	**(3,940)**	**(3,085)**
Occupancy and rent	(1,137)	(1,079)
Depreciation and amortization	(837)	(730)
Software cost	(139)	(103)
Communications	(137)	(82)
Representation	(123)	(44)
Legal and consultancy	(102)	(75)
Business travel and related	(82)	(61)
Repair and maintenance of property and equipment	(65)	(25)
Marketing and advertising	(53)	(130)
Office supplies	(51)	(37)
Security	(45)	(24)
Operating taxes	(27)	(27)
Utilities	(10)	(6)
Other expenses	(65)	(55)
Other operating expenses	**(2,873)**	**(2,478)**
Total operating expenses	**(6,813)**	**(5,563)**

20. Risk management

Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's 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.

(Thousands of Azerbaijani Manats)

20. Risk management (continued)

Introduction (continued)

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.

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. Each business group has a decentralised 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 analyse, control and identify early risks. On a regular basis detailed reporting of industry and customer risks takes place.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry.

(Thousands of Azerbaijani Manats)

20. Risk management (continued)

Introduction (continued)

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.

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.

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.

In the table below loans to banks and customers of high grade are those having a minimal level of credit risk, normally with a credit rating on or close to sovereign level or very well collateralized. Other borrowers with good financial position and good debt service are included in the standard grade. Sub-standard grade comprises loans below standard grade but not individually impaired.

		Neither past due nor impaired					
	Notes	***High grade 2012***	***Standard grade 2012***	***Sub-standard grade 2012***	***Past due but not impaired 2012***	***Individually impaired 2012***	***Total 2012***
Due from banks	6	-	3,716	-	-	981	4,697
Loans to customers	7						
Auto lending		-	26,814	-	1,531	264	28,609
Corporate lending		-	21,737	-	417	871	23,025
Small business lending		-	17,585	313	265	439	18,602
Consumer lending		-	3,292	-	331	-	3,623
Total gross balances		**-**	**73,144**	**313**	**2,544**	**2,555**	**78,556**

(Thousands of Azerbaijani Manats)

20. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets (continued)

		Neither past due nor impaired					
	Notes	***High grade 2011***	***Standard grade 2011***	***Sub-standard grade 2011***	***Past due but not impaired 2011***	***Individually impaired 2011***	***Total 2011***
Due from banks	6	-	485	-	-	-	485
Loans to customers	7						
Auto lending		-	7,687	-	718	11	8,416
Corporate lending		-	33,679	-	635	379	34,693
Small business lending		-	298	49	328	1,358	2,033
Consumer lending		-	1,179	-	103	-	1,282
Total gross balances		**-**	**43,328**	**49**	**1,784**	**1,748**	**46,909**

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

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.

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

	Less than 30 days 2012	***31 to 60 days 2012***	***61 to 90 days 2012***	***More than 90 days 2012***	***Total 2012***
Loans to customers					
Auto lending	889	242	134	266	**1,531**
Corporate lending	-	417	-	-	**417**
Small business lending	233	5	-	27	**265**
Consumer lending	115	40	48	128	**331**
Total	**1,237**	**704**	**182**	**421**	**2,544**

	Less than 30 days 2011	***31 to 60 days 2011***	***61 to 90 days 2011***	***More than 90 days 2011***	***Total 2011***
Loans to customers					
Auto lending	591	71	28	28	**718**
Corporate lending	42	71	522	-	**635**
Small business lending	328	-	-	-	**328**
Consumer lending	87	8	2	6	**103**
Total	**1,048**	**150**	**552**	**34**	**1,784**

See Note 8 for more detailed information with respect to the allowance for impairment of loans to customers.

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 180 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

(Thousands of Azerbaijani Manats)

20. Risk management (continued)

Credit risk (continued)

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the 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:

	2012				*2011*			
	Azerbaijan	***OECD***	***CIS and other foreign banks***	***Total***	***Azerbaijan***	***OECD***	***CIS and other foreign banks***	***Total***
Assets:								
Cash and cash equivalents	4,329	566	634	5,529	971	57	53	1081
Mandatory reserve with the CBAR	1,336	-	-	1,336	773	-	-	773
Due from banks	3,696	20	-	3,716	465	20	-	485
Loans to customers	72,070	-	-	72,070	45,098	-	-	45,098
Other financial assets	65	12	-	77	43	-	-	43
	81,496	**598**	**634**	**82,728**	**47,350**	**77**	**53**	**47,480**
Liabilities:								
Due to banks	(2)	-	(53,737)	(53,739)	-	-	(26,902)	(26,902)
Customer accounts	(14,360)	-	-	(14,360)	(4,403)	-	-	(4,403)
Other financial liabilities	(68)	-	-	(68)	(12)	-	-	(12)
Subordinated debts	-	-	(4,381)	(4,381)	-	-	(3,366)	(3,366)
	(14,430)	**-**	**(58,118)**	**(72,548)**	**(4,415)**	**-**	**(30,268)**	**(34,683)**
Net assets / (liabilities)	**67,066**	**598**	**(57,484)**	**10,180**	**42,935**	**77**	**(30,215)**	**12,797**

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.

(Thousands of Azerbaijani Manats)

20. Risk management (continued)

Liquidity risk and funding management (continued)

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 at 31 December, these ratios were as follows:

	2012	*2011*
Instant Liquidity Ratio	178.9%	280.1%

Analysis of financial liabilities by remaining contractual maturities

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

Financial liabilities As at 31 December 2012	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Due to banks	10,396	11,649	36,898	-	58,943
Customer accounts	5,024	9,373	508	-	14,905
Other liabilities	68	-	-	-	68
Subordinated loans	100	307	1,629	4,715	6,751
Total undiscounted financial liabilities	**15,588**	**21,329**	**39,035**	**4,715**	**80,667**

Financial liabilities As at 31 December 2011	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Due to banks	27,178	-	-	-	27,178
Customer accounts	1110	86	3,301	-	4,497
Other liabilities	288	-	-	-	288
Subordinated loans	27	3,400	-	-	3,427
Total undiscounted financial liabilities	**28,603**	**3,486**	**3,301**	**-**	**35,390**

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

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
2012	392	831	3,946	-	5,169
2011	-	629	609	-	1,238

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

The Bank's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant concentration as of 31 December 2012 of deposits from insurance companies, 56% of total portfolio (2011-53%) in the period less than one year.

As at 31 December 2012 the Bank has significant financing from the Parent totaling AZN 41,311 (2011- AZN 30,268). 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.

(Thousands of Azerbaijani Manats)

20. Risk management (continued)

Liquidity risk and funding management (continued)

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

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 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 % 2012*	*Effect on profit before tax 2012*	*Increase in currency rate in % 2011*	*Effect on profit before tax 2011*
USD	3.82	7	5.1	10
EUR	11.49	10	14.6	7

Currency	*Decrease in currency rate in % 2012*	*Effect on profit before tax 2012*	*Decrease in currency rate in % 2011*	*Effect on profit before tax 2011*
USD	3.82	(7)	5.1	(10)
EUR	11.49	(10)	14.6	(7)

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.

(Thousands of Azerbaijani Manats)

21. Fair values of financial instruments

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

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

	Carrying value 2012	***Fair value 2012***	***Unrecognised gain / (loss) 2012***	***Carrying value 2011***	***Fair value 2011***	***Unrecognised gain / (loss) 2011***
Financial assets						
Cash and cash equivalents	5,529	5,529	-	1,081	1,081	-
Mandatory reserves with CBAR	1,336	1336	-	773	773	-
Due from banks	3,716	3,716	-	485	485	-
Loans to customers	72,070	72,165	(95)	45,098	45,098	-
Other financial assets	77	77	-	43	43	-
Financial liabilities						
Due to banks	53,739	53,739	-	26,902	26,902	-
Customer accounts	14,360	14,360	-	4,403	4,403	-
Other financial liabilities	68	68	-	12	12	
Subordinated loans	4,381	4,381	-	3,366	3,366	-
Total unrecognised change in unrealised fair value			**(95)**			**-**

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.

22. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 20 "Risk management" for the Bank's contractual undiscounted repayment obligations and how management addresses the negative maturity mismatch below for within one year.

	2012			***2011***		
	Within one year	***More than one year***	***Total***	***Within one year***	***More than one year***	***Total***
Cash and cash equivalents	5,529	-	5,529	1,081	-	1,081
Mandatory reserves with CBAR	1,336	-	1,336	773	-	773
Due from banks	3,716	-	3,716	485	-	485
Loans to customers	4,902	67,168	72,070	25,016	20,082	45,098
Property and equipment	-	932	932	-	1,345	1,345
Intangible assets	-	1,204	1,204	-	833	833
Other assets	706	-	706	542	-	542
Total	16,189	69,304	85,493	27,897	22,260	50,157
Due to banks	19,968	33,771	53,739	26,902	-	26,902
Customer accounts	13,858	502	14,360	1,194	3,209	4,403
Other liabilities	178	-	178	358	-	358
Subordinated debts	-	4,381	4,381	3,366	-	3,366
Total	34,004	38,654	72,658	31,820	3,209	35,029
Net	**(17,815)**	**30,650**	**12,835**	**(3,923)**	**19,051**	**15,128**

(Thousands of Azerbaijani Manats)

23. Related party disclosures

In accordance with IAS 24 "Related Party Disclosures", parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The outstanding balances of related party transactions are as follows:

	2012			2011		
	Parent	Entities under common control	Other related parties	Parent	Entities under common control	Other related parties
Loans outstanding at 1 January, gross	-	-	24	-	-	35
Loans issued during the year	-	-	-	-	-	-
Loan repayments during the year	-	-	(24)	-	-	(11)
Loans outstanding at 31 December, gross	-	-	-	-	-	24
Deposits at 1 January	-	990	8	-	979	-
Deposits received during the year	-	215	-	-	11	8
Deposits repaid during the year	-	-	(8)	-	-	-
Deposits at 31 December	-	1,205	-	-	990	8
Current accounts at 31 December	-	5	-	-	18	-
Cash and cash equivalents	595	564	-	41	16	-
Due from banks	-	20	-	-	20	-
Due to banks	36,930	-	-	26,902	-	-
Subordinated debts	4,381	-	-	3,366	-	-
Commitments and guarantees issued	-	20	-	-	24	-

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

	For the year ended 31 December					
	2012			2011		
	Parent	Entities under common control	Other related parties	Parent	Entities under common control	Other related parties
Interest income	-	-	-	-	-	8
Interest expense	(1,172)	(101)	-	(897)	(98)	(1)
Fee and commission income	60	-	-	-	1	-
Other income	-	43	-	-	21	-
Fee and commission expense	(3)	(10)	-	(1)	(5)	-
Other operating expenses	(1)	(46)	-	-	-	(121)

Compensation of key management personnel was comprised of the following:

	2012	2011
Salaries and other short-term benefits	623	393
Social security costs	137	87
Total key management personnel compensation	**760**	**480**

(Thousands of Azerbaijani Manats)

24. Capital adequacy

The objectives of management when managing the Bank's capital are (i) to comply with the capital requirements set by CBAR, (ii) to safeguard the Bank's ability to continue as a going concern and (iii) to maintain strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value. Compliance with capital adequacy ratios set by CBAR is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's 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 10,000 (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% (2011- 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% (2011- 6%).

Management believes that the Bank was in compliance with the statutory capital adequacy ratio throughout 2012 and 2011.

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 will come into force from January 1, 2014.

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

	2012	*2011*
Tier 1 capital	11,362	14,241
Tier 2 capital	5,432	2,198
Less: deductions from capital	(1,204)	(833)
Total regulatory capital	**15,590**	**15,606**
Risk-weighted assets	**85,986**	**53,158**
Tier 1 capital adequacy ratio	11.8%	25.2%
Total capital adequacy ratio	18.1%	29.4%

25. Events after the reporting period

During January 2013 the Bank attracted three long-term and two-short term funds from the Parent in the amount of AZN 6,922 and AZN 2,987, respectively. Borrowings are denominated in USD with average annual interest rate of 5.51% p.a. and 0.6% p.a., respectively. Long term borrowings are maturing in 2016-2018.

In January and February 2013 the Bank repaid funds borrowed from the Parent in the amount of AZN 1,570 and AZN 2,987 equivalent denominated in USD, respectively.