

**TURANBANK OPEN
JOINT- STOCK COMPANY**

**Consolidated Financial Statements
for the year ended 31 December 2013**

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Independent Auditors' Report

To the Supervisory Board of TuranBank Open Joint-Stock Company

We have audited the accompanying consolidated financial statements of TuranBank Open Joint-Stock Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2013, and the consolidated statements of profit or loss and other comprehensive income, changes in equity and cash flows for 2013, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

KPMG Azerbaijan Limited

24 April 2014

Baku, the Republic of Azerbaijan

TuranBank OJSC
*Consolidated Statement of Profit or Loss and Other Comprehensive Income for the year
 ended 31 December 2013*

	Notes	2013 AZN'000	2012 AZN'000
Interest income	4	23,345	19,052
Interest expense	4	(11,726)	(9,728)
Net interest income		11,619	9,324
Fee and commission income	5	3,560	3,300
Fee and commission expense	6	(640)	(510)
Net fee and commission income		2,920	2,790
Net gain from trading in foreign currencies		935	896
Net foreign exchange income		44	18
Other operating income		16	31
Operating income		15,534	13,059
Impairment losses		(1,820)	(1,559)
Personnel expenses	7	(5,162)	(3,942)
Other general administrative expenses	8	(3,771)	(3,545)
Profit before income tax		4,781	4,013
Income tax expense	9	(967)	(827)
Profit for the year		3,814	3,186
Other comprehensive income, net of income tax			
<i>Items that are or may be reclassified subsequently to profit or loss:</i>			
Revaluation reserve for available-for-sale financial assets:			
- Net change in fair value		38	20
<i>Total items that are or may be reclassified subsequently to profit or loss</i>		<i>38</i>	<i>20</i>
<i>Items that will not be reclassified to profit or loss:</i>			
Revaluation of buildings		660	-
<i>Total items that will not be reclassified to profit or loss</i>		<i>660</i>	<i>-</i>
Other comprehensive income for the year, net of income tax		698	20
Total comprehensive income for the year		4,512	3,206
Earnings per share			
Basic earnings per share (expressed in AZN)	21	112	138

The consolidated financial statements as set out on pages 4 to 69 were approved by management on 24 April 2014 and were signed on its behalf by:

Mr. Nazim Sadigov
 Chairman of the Management Board




Mr. Alizaman Ibrahimov
 Head of Financial Management Department

The consolidated statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements.

TuranBank OJSC
Consolidated Statement of Financial Position as at 31 December 2013

	Notes	2013 AZN'000	2012 AZN'000
ASSETS			
Cash and cash equivalents	10	40,551	36,305
Available-for-sale financial assets	11	1,158	1,649
Loans to banks	12	12,388	7,215
Loans to customers	13	177,608	161,279
Property, equipment and intangible assets	14	11,696	9,611
Other assets	15	936	1,014
Total assets		244,337	217,073
LIABILITIES			
Deposits and balances from banks	16	27,138	25,531
Current accounts and deposits from customers	17	108,167	102,760
Other borrowed funds	18	59,962	56,199
Current tax liability		409	329
Deferred tax liabilities	9	236	32
Other liabilities	19	318	352
Total liabilities		196,230	185,203
EQUITY			
Share capital	20	44,002	30,001
Share premium		724	-
Revaluation surplus for buildings		1,327	667
Revaluation reserve for available-for-sale financial assets		58	20
Retained earnings		1,996	1,182
Total equity		48,107	31,870
Total liabilities and equity		244,337	217,073


Mr. Nazim Sadigov
Chairman of the Management Board




Mr. Alizaman Ibrahimov
Head of Financial Management Department

The consolidated statement of financial position is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements.

TuranBank OJSC
Consolidated Statement of Cash Flows for the year ended 31 December 2013

	Notes	2013 AZN'000	2012 AZN'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest receipts		22,996	18,456
Interest payments		(11,293)	(9,320)
Fee and commission receipts		3,560	3,300
Fee and commission payments		(640)	(510)
Net receipts from foreign exchange		935	896
Dividends received		-	24
Other income receipts		7	7
Other general administrative expenses payments		(8,141)	(6,786)
(Increase) decrease in operating assets			
Loans to banks		(5,151)	(3,272)
Loans to customers		(17,822)	(45,273)
Other assets		106	(321)
Increase (decrease) in operating liabilities			
Deposits and balances from banks		1,469	18,191
Current accounts and deposits from customers		5,060	15,813
Other liabilities		(34)	68
Net cash used in operating activities before income tax paid		(8,948)	(8,727)
Income tax paid		(857)	(635)
Cash flows used in operations		(9,805)	(9,362)
CASH FLOWS FROM INVESTING ACTIVITIES			
Sale and repayment of available-for-sale financial assets		539	6,753
Purchases of property and equipment and intangible assets		(2,082)	(2,007)
Sales of property and equipment and intangible assets		10	2
Cash flows (used in)/from investing activities		(1,533)	4,748
CASH FLOWS FROM FINANCING ACTIVITIES			
Receipts of other borrowed funds		27,981	20,126
Repayment of other borrowed funds		(24,166)	(11,670)
Proceeds from issuance of share capital		11,725	6,197
Dividends paid		-	(1,279)
Cash flows from financing activities		15,540	13,374
Net increase in cash and cash equivalents		4,202	8,760
Effect of changes in exchange rates on cash and cash equivalents		44	18
Cash and cash equivalents as at the beginning of the year		36,305	27,527
Cash and cash equivalents as at the end of the year	10	40,551	36,305

Mr. Nazim Sadigov
Chairman of the Management Board



Alizaman Ibrahimov
Mr. Alizaman Ibrahimov
Head of Financial Management Department

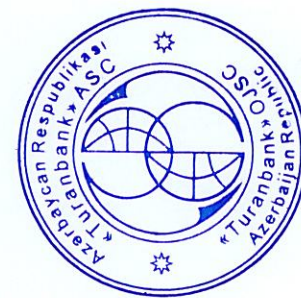
The consolidated statement of cash flows is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements.

AZN'000	Share capital	Share premium	Revaluation surplus for buildings	Revaluation reserve for available-for-sale financial assets	Retained earnings	Total equity
Balance as at 1 January 2012	22,000	-	710	-	1,178	23,888
Total comprehensive income						
Profit for the year	-	-	-	-	3,186	3,186
Other comprehensive income						
<i>Items that are or may be reclassified subsequently to profit or loss:</i>						
Net change in fair value of available-for-sale financial assets transferred to profit or loss, net of deferred tax	-	-	-	20	-	20
<i>Total items that are or may be reclassified subsequently to profit or loss</i>	-	-	-	20	-	20
<i>Items that will not be reclassified to profit or loss:</i>						
Depreciation for buildings revaluation surplus	-	-	(43)	-	43	-
<i>Total items that will not be reclassified to profit or loss</i>	-	-	(43)	-	43	-
Total other comprehensive income	-	-	(43)	20	43	20
Total comprehensive income for the year	-	-	(43)	20	3,229	3,206
Transactions with owners, recorded directly in equity						
Shares issued (Note 20)	6,197	-	-	-	-	6,197
Transfer of profit and issue of share capital (Note 20)	1,804	-	-	-	(1,804)	-
Dividends declared (Note 20)	-	-	-	-	(1,421)	(1,421)
Total transactions with owners	8,001	-	-	-	(3,225)	4,776
Balance as at 31 December 2012	30,001	-	667	20	1,182	31,870

The consolidated statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements.

TuranBank OJSC
Consolidated Statement of Changes in Equity for the year ended 31 December 2013

AZN'000	Share capital	Share premium	Revaluation surplus for buildings	Revaluation reserve for available-for-sale financial assets	Retained earnings	Total equity
Balance as at 1 January 2013	30,001	-	667	20	1,182	31,870
Total comprehensive income	-	-	-	-	3,814	3,814
Profit for the year	-	-	-	-	3,814	3,814
Other comprehensive income						
<i>Items that are or may be reclassified subsequently to profit or loss:</i>						
Net change in fair value of available-for-sale financial assets transferred to profit or loss, net of deferred tax	-	-	-	38	-	38
<i>Total items that are or may be reclassified subsequently to profit or loss</i>	-	-	-	38	-	38
<i>Items that will not be reclassified to profit or loss:</i>						
Revaluation of property and equipment, net of deferred tax	-	-	660	-	-	660
<i>Total items that will not be reclassified to profit or loss</i>	-	-	660	-	-	660
Total other comprehensive income	-	-	660	38	-	698
Total comprehensive income for the year	-	-	660	38	3,814	4,512
Transactions with owners, recorded directly in equity						
Shares issued	11,001	724	-	-	-	11,725
Transfer of profit and issue of share capital	3,000	-	-	-	(3,000)	-
Total transactions with owners	14,001	724	-	-	(3,000)	11,725
Balance as at 31 December 2013	44,002	724	1,327	58	1,996	48,107




Mr. Nazim Sadigov
Chairman of the Management Board


Mr. Alizaman Ibrahimov
Head of Financial Management Department

1 Background

(a) Organization and operations

These consolidated financial statements include the financial statements of TuranBank Open Joint-Stock Company (the Bank) and its subsidiary Turanleasing LLC (together referred to as the Group). The subsidiary is a leasing company.

The Bank was established in the Republic of Azerbaijan as an Open Joint Stock Company on 12 June 1992. The principal activities are deposit taking and customer account maintenance, lending, issuing guarantees, cash and settlement operations and transactions with securities and foreign exchange, also in accordance with banking license the Bank has a right to perform operations with precious metals. The activities of the Bank are regulated by the Central Bank of Azerbaijan (CBAR). The Bank has a general banking license, and is a member of the state deposit insurance system, which was introduced by the Azerbaijani Law, "Deposits of individuals insurance in Azerbaijan Republic" dated 29 December 2006. The State Deposit Insurance Fund guarantees repayment of 100% of individual deposits in the following order:

- until 1 January 2008 – up to AZN 4,000;
- from 1 January 2008 until 1 January 2010 – up to AZN 6,000;
- from 1 January 2010 until 1 August 2013 – up to AZN 30,000 for deposits with interest yield of 12% p.a. or less.
- from 1 August 2013 and afterwards - up to AZN 30,000 for deposits with interest yield of 10% p.a. or less.

Deposits with interest yield above 10% are not covered by the programme.

The Bank's registered address is: 85 Ismail bey Gutgashinly street, AZ1073, Baku, the Republic of Azerbaijan.

The Bank has twelve branches and one sub-branch (2012: thirteen branches and one sub-branch) within the Republic of Azerbaijan. Five branches are located in Baku, seven branches and one sub-branch are located in other regions of Azerbaijan. The majority of the assets and liabilities are located in the Republic of Azerbaijan.

On 21 August 2006, the Bank registered TuranLeasing LLC ("TuranLeasing") with the Ministry of Justice of the Republic of Azerbaijan. The company commenced its operations in September 2006, and is owned 100% by the Bank.

As at 31 December 2013 the Bank has 27 shareholders each having less than 10% ownership. The Bank has no ultimate controlling party who has the power to direct the transactions of the Group at his own discretion and for his own benefit.

(b) Business environment

Azerbaijan business environment

The Group's operations are primarily located in Azerbaijan. Consequently, the Group is exposed to the economic and financial markets of Azerbaijan which display characteristics of an emerging market. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in Azerbaijan. The consolidated financial statements reflect management's assessment of the impact of the Azerbaijan business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

2 Basis of preparation

(a) Statement of compliance

The accompanying consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS).

(b) Basis of measurement

The consolidated financial statements are prepared on the historical cost basis except that available-for-sale financial assets are stated at fair value, and buildings are stated at revalued amounts.

(c) Functional and presentation currency

The functional currency of the Group and of its subsidiary is the Azerbaijani Manat (“AZN”) as, being the national currency of the Republic of Azerbaijan, it reflects the economic substance of the majority of underlying events and circumstances relevant to them.

The AZN is also the presentation currency for the purposes of these consolidated financial statements.

Financial information presented in AZN is rounded to the nearest thousand.

(d) Use of estimates and judgments

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results could differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies is described in the following notes:

- loan impairment estimates - note 13
- building revaluation estimates - note 14
- estimates of fair values of financial assets and liabilities – note 29

(e) Changes in accounting policies and presentation

The Group has adopted the following new standards and amendments to standards, including any consequential amendments to other standards, with a date of initial application of 1 January 2013.

- IFRS 10 *Consolidated Financial statements* (see (i))
- IFRS 12 *Disclosure of Interests in Other Entities* (see (ii))
- IFRS 13 *Fair Value Measurements* (see (iii))
- *Presentation of Items of Other Comprehensive Income* (Amendments to IAS 1 *Presentation of Financial Statements*) (see (iv))
- *Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7) (see (v))

2 Basis of preparation, continued

(e) Changes in accounting policies and presentation, continued

The nature and the effect of the changes are explained below.

(i) *Subsidiaries, including structured entities*

As a result of adoption of IFRS 10, the Group changed its accounting policy with respect to determining whether it has control over and consequently whether it consolidates its investees. IFRS 10 introduces a new control model that is applicable to all investees, including structured entities. See notes 3 (a) (i).

In accordance with the transitional provisions of IFRS 10, the Group reassessed the control conclusion for its investees as at 1 January 2013. The Group determined that its consolidated group structure remained unchanged under IFRS 10, and as a result, the consolidated financial statements are unaffected.

(ii) *Disclosure of Interests in Other Entities*

The new standard contains disclosure requirements for entities that have interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. Interests are widely defined as contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. The expanded and new disclosure requirements aim to provide information to enable the users to evaluate the nature of risks associated with an entity's interests in other entities and the effects of those interests on the entity's financial position, financial performance and cash flows.

As a result of adoption of IFRS 12, the Group included new disclosures in the consolidated financial statements that are required under IFRS 12 and provided comparative information for new disclosures.

(iii) *Fair value measurement*

IFRS 13 establishes a single framework for measuring fair value and making disclosures about fair value measurements, when such measurements are required or permitted by other IFRSs. In particular, it unifies the definition of fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It also replaces and expands the disclosure requirements about fair value measurements in other IFRSs, including IFRS 7 *Financial Instruments: Disclosures*. (see note 29).

As a result, the Group adopted a new definition of fair value, as set out in note 3(d) (v). The change had no significant impact on the measurements of assets and liabilities. However, the Group included new disclosures in the consolidated financial statements that are required under IFRS 13, comparatives not restated.

(iv) *Presentation of items of other comprehensive income*

As a result of the amendments to IAS 1, the Group modified the presentation of items of other comprehensive income in its consolidated statement of profit or loss and other comprehensive income, to present separately items that would be reclassified to profit or loss in the future from those that would never be. Comparative information is also re-presented accordingly.

2 Basis of preparation, continued

(e) Changes in accounting policies and presentation, continued

(v) *Financial instruments: Disclosures – Offsetting financial assets and financial liabilities*

Amendments to IFRS 7 *Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities* introduced new disclosure requirements for financial assets and liabilities that are offset in the statement of financial position or subject to master netting arrangements or similar agreements.

As the Group is not setting off financial instruments in accordance with IAS 32 *Financial instruments: disclosure and presentation* and does not have relevant offsetting arrangements, the amendment does not have an impact on the consolidated financial statements of the Group.

3 Significant accounting policies

The accounting policies set out below are applied consistently to all periods presented in these consolidated financial statements, and are applied consistently by Group entities, except as explained in note 2(e), which addresses changes in accounting policies.

(a) Basis of consolidation

(i) *Subsidiaries*

Subsidiaries are investees controlled by the Group. The Group controls an investee when it is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. In particular the Group consolidates investees that it controls on the basis of de facto circumstances. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

(ii) *Transactions eliminated on consolidation*

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

(b) Foreign currency

Transactions in foreign currencies are translated to the respective functional currencies of the Group entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value is determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

3 Significant accounting policies, continued

(b) Foreign currency, continued

Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments unless the difference is due to impairment in which case foreign currency differences that have been recognised in other comprehensive income are reclassified to profit or loss; a financial liability designated as a hedge of the net investment in a foreign operation to the extent that the hedge is effective; or qualifying cash flow hedges to the extent that the hedge is effective, which are recognised in other comprehensive income.

(c) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances (nostro accounts) held with the CBAR and other banks, and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Group in the management of short-term commitments. The mandatory reserve deposit with the CBAR is not considered to be a cash equivalent due to restrictions on its withdrawability. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

(d) Financial instruments

(i) Classification

Financial instruments at fair value through profit or loss are financial assets or liabilities that are:

- acquired or incurred principally for the purpose of selling or repurchasing in the near term
- part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking
- derivative financial instruments (except for derivative that is a financial guarantee contract or a designated and effective hedging instruments) or,
- upon initial recognition, designated as at fair value through profit or loss.

The Group may designate financial assets and liabilities at fair value through profit or loss where either:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise or,
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

All trading derivatives in a net receivable position (positive fair value), as well as options purchased, are reported as assets. All trading derivatives in a net payable position (negative fair value), as well as options written, are reported as liabilities.

3 Significant accounting policies, continued

(d) Financial instruments, continued

(i) *Classification, continued*

Management determines the appropriate classification of financial instruments in this category at the time of the initial recognition. Derivative financial instruments and financial instruments designated as at fair value through profit or loss upon initial recognition are not reclassified out of at fair value through profit or loss category. Financial assets that would have met the definition of loans and receivables may be reclassified out of the fair value through profit or loss or available-for-sale category if the Group has an intention and ability to hold them for the foreseeable future or until maturity. Other financial instruments may be reclassified out of at fair value through profit or loss category only in rare circumstances. Rare circumstances arise from a single event that is unusual and highly unlikely to recur in the near term.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that the Group:

- intends to sell immediately or in the near term
- upon initial recognition designates as at fair value through profit or loss
- upon initial recognition designates as available-for-sale or,
- may not recover substantially all of its initial investment, other than because of credit deterioration.

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity, other than those that:

- the Group upon initial recognition designates as at fair value through profit or loss
- the Group designates as available-for-sale or,
- meet the definition of loans and receivables.

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified as loans and receivables, held-to-maturity investments or financial instruments at fair value through profit or loss.

(ii) *Recognition*

Financial assets and liabilities are recognized in the consolidated statement of financial position when the Group becomes a party to the contractual provisions of the instrument. All regular way purchases of financial assets are accounted for at the settlement date.

(iii) *Measurement*

A financial asset or liability is initially measured at its fair value plus, in the case of a financial asset or liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.

Subsequent to initial recognition, financial assets, including derivatives that are assets, are measured at their fair values, without any deduction for transaction costs that may be incurred on sale or other disposal, except for:

- loans and receivables which are measured at amortized cost using the effective interest method

3 Significant accounting policies, continued

(d) Financial instruments, continued

(iii) *Measurement, continued*

- held-to-maturity investments that are measured at amortized cost using the effective interest method

- investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured which are measured at cost.

All financial liabilities, other than those designated at fair value through profit or loss and financial liabilities that arise when a transfer of a financial asset carried at fair value does not qualify for derecognition, are measured at amortized cost.

(iv) *Amortised cost*

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortized based on the effective interest rate of the instrument.

(v) *Fair value measurement principles*

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

When there is no quoted price in an active market, the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all the factors that market participants would take into account in these circumstances.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price, i.e., the fair value of the consideration given or received. If the Group determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is supported wholly by observable market data or the transaction is closed out.

If an asset or a liability measured at fair value has a bid price and an ask price, the Group measures assets and long positions at the bid price and liabilities and short positions at the ask price.

The Group recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

3 Significant accounting policies, continued

(d) Financial instruments, continued

(vi) *Gains and losses on subsequent measurement*

A gain or loss arising from a change in the fair value of a financial asset or liability is recognized as follows:

- a gain or loss on a financial instrument classified as at fair value through profit or loss is recognized in profit or loss

- a gain or loss on an available-for-sale financial asset is recognized as other comprehensive income in equity (except for impairment losses and foreign exchange gains and losses on debt financial instruments available-for-sale) until the asset is derecognized, at which time the cumulative gain or loss previously recognised in equity is recognized in profit or loss. Interest in relation to an available-for-sale financial asset is recognized in profit or loss using the effective interest method.

For financial assets and liabilities carried at amortized cost, a gain or loss is recognized in profit or loss when the financial asset or liability is derecognized or impaired, and through the amortization process.

(vii) *Derecognition*

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability in the consolidated statement of financial position. The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

The Group enters into transactions whereby it transfers assets recognised on its consolidated statement of financial position, but retains either all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised.

In transactions where the Group neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset, it derecognises the asset if control over the asset is lost.

In transfers where control over the asset is retained, the Group continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred assets.

If the Group purchases its own debt, it is removed from the consolidated statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from early retirement of debt.

The Group writes off assets deemed to be uncollectible.

(viii) *Offsetting*

Financial assets and liabilities are offset and the net amount reported in the consolidated 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 realise the asset and settle the liability simultaneously.

3 Significant accounting policies, continued

(e) Property and equipment

(i) Owned assets

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses, except for buildings, which are stated at revalued amounts as described below.

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

(ii) Leased assets

Leases under which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Equipment acquired by way of finance lease is stated at the amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses.

(iii) Revaluation

Buildings are subject to revaluation on a regular basis. The frequency of revaluation depends on the movements in the fair values of the buildings being revalued. A revaluation increase on a building is recognised as other comprehensive income except to the extent that it reverses a previous revaluation decrease recognised in profit or loss, in which case it is recognised in profit or loss. A revaluation decrease on a building is recognised in profit or loss except to the extent that it reverses a previous revaluation increase recognised as other comprehensive income directly in equity, in which case it is recognised in other comprehensive income.

(iv) Depreciation

Depreciation is charged to profit or loss on a straight-line basis over the estimated useful lives of the individual assets. Depreciation commences on the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Land is not depreciated. The estimated useful lives are as follows:

- buildings	33 to 34 years
- leasehold improvement	14 years
- fixtures and fittings	5 years
- other fixed assets	5 years
- equipment	4 years

(f) Intangible assets

Acquired intangible assets are stated at cost less accumulated amortisation and impairment losses.

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Amortisation is charged to profit or loss on a straight-line basis over the estimated useful lives of intangible assets. The estimated useful lives range from 7 to 10 years.

3 Significant accounting policies, continued

(g) Assets held for sale

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets, or components of a disposal group, are remeasured in accordance with the Group's accounting policies. Thereafter generally, the assets, or disposal group, are measured at the lower of their carrying amount and fair value less cost to sell.

(h) Impairment

The Group assesses at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the Group determines the amount of any impairment loss.

A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a loss event) and that event (or events) has had an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, breach of loan covenants or conditions, restructuring of financial asset or group of financial assets that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, deterioration in the value of collateral, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers in the group, or economic conditions that correlate with defaults in the group.

In addition, for an investment in an equity security available-for-sale a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

(i) *Financial assets carried at amortized cost*

Financial assets carried at amortized cost consist principally of loans and other receivables (loans and receivables). The Group reviews its loans and receivables to assess impairment on a regular basis.

The Group first assesses whether objective evidence of impairment exists individually for loans and receivables that are individually significant, and individually or collectively for loans and receivables that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed loan or receivable, whether significant or not, it includes the loan or receivable in a group of loans and receivables with similar credit risk characteristics and collectively assesses them for impairment. Loans and receivables 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 objective evidence that an impairment loss on a loan or receivable has been incurred, the amount of the loss is measured as the difference between the carrying amount of the loan or receivable and the present value of estimated future cash flows including amounts recoverable from guarantees and collateral discounted at the loan or receivable's original effective interest rate. Contractual cash flows and historical loss experience adjusted on the basis of relevant observable data that reflect current economic conditions provide the basis for estimating expected cash flows.

3 Significant accounting policies, continued

(h) Impairment, continued

(i) *Financial assets carried at amortized cost, continued*

In some cases the observable data required to estimate the amount of an impairment loss on a loan or receivable may be limited or no longer fully relevant to current circumstances. This may be the case when a borrower is in financial difficulties and there is little available historical data relating to similar borrowers. In such cases, the Group uses its experience and judgment to estimate the amount of any impairment loss.

All impairment losses in respect of loans and receivables are recognized in profit or loss and are only reversed if a subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

When a loan is uncollectable, it is written off against the related allowance for loan impairment. The Group writes off a loan balance (and any related allowances for loan losses) when management determines that the loans are uncollectible and when all necessary steps to collect the loan are completed.

(ii) *Financial assets carried at cost*

Financial assets carried at cost include unquoted equity instruments included in available-for-sale financial assets that are not carried at fair value because their fair value cannot be reliably measured. If there is objective evidence that such investments are impaired, the impairment loss is calculated as the difference between the carrying amount of the investment and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset.

All impairment losses in respect of these investments are recognized in profit or loss and cannot be reversed.

(iii) *Available-for-sale financial assets*

Impairment losses on available-for-sale financial assets are recognised by transferring the cumulative loss that is recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed, with the amount of the reversal recognised in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

3 Significant accounting policies, continued

(h) Impairment, continued

(iv) Non financial assets

Other non financial assets, other than deferred taxes, are assessed at each reporting date for any indications of impairment. The recoverable amount of goodwill is estimated at each reporting date. The recoverable amount of non financial assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. An impairment loss is recognised when the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

All impairment losses in respect of non financial assets are recognized in profit or loss and reversed only if there has been a change in the estimates used to determine the recoverable amount. Any impairment loss reversed is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. An impairment loss in respect of goodwill is not reversed.

(i) Provisions

A provision is recognised in the consolidated statement of financial position when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating costs are not provided for.

(j) Credit related commitments

In the normal course of business, the Group enters into credit related commitments, comprising undrawn loan commitments, letters of credit and guarantees, and provides other forms of credit insurance.

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

A financial guarantee liability is recognised initially at fair value net of associated transaction costs, and is measured subsequently at the higher of the amount initially recognised less cumulative amortisation or the amount of provision for losses under the guarantee. Provisions for losses under financial guarantees and other credit related commitments are recognised when losses are considered probable and can be measured reliably.

Financial guarantee liabilities and provisions for other credit related commitment are included in other liabilities.

3 Significant accounting policies, continued

(j) Credit related commitments, continued

Loan commitments are not recognised, except for the followings:

- loan commitments that the Group designates as financial liabilities at fair value through profit or loss
- if the Group has a past practice of selling the assets resulting from its loan commitments shortly after origination, then the loan commitments in the same class are treated as derivative instruments
- loan commitments that can be settled net in cash or by delivering or issuing another financial instrument
- commitments to provide a loan at a below-market interest rate.

(k) Share capital

(i) Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

(ii) Repurchase of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a decrease in equity.

(iii) Dividends

The ability of the Group to declare and pay dividends is subject to the rules and regulations of the Azerbaijani legislation.

Dividends in relation to ordinary shares are reflected as an appropriation of retained earnings in the period when they are declared.

(l) Taxation

Income tax comprises current and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items of other comprehensive income or transactions with shareholders recognised directly in equity, in which case it is recognised within other comprehensive income or directly within equity.

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities are recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax assets and liabilities are not recognised for the following temporary differences: goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit and temporary differences related to investments in subsidiaries where the parent is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

3 Significant accounting policies, continued

(l) Taxation, continued

The measurement of deferred tax assets and liabilities reflects the tax consequences that would follow the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences, unused tax losses and credits can be utilised. Deferred tax assets are reduced to the extent that taxable profit will be available against which the deductible temporary differences can be utilized.

(m) Income and expense recognition

Interest income and expense are recognised in profit or loss using the effective interest method.

Loan origination fees, loan servicing fees and other fees that are considered to be integral to the overall profitability of a loan, together with the related transaction costs, are deferred and amortized to interest income over the estimated life of the financial instrument using the effective interest method.

Other fees, commissions and other income and expense items are recognised in profit or loss when the corresponding service is provided.

Dividend income is recognised in profit or loss on the date that the dividend is declared.

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

(n) Segment reporting

An operating segment is a component of a Group that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same Group); whose operating results are regularly reviewed by the chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

(o) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective as at 31 December 2013, and are not applied in preparing these consolidated financial statements. Of these pronouncements, potentially the following will have an impact on the financial position and performance. The Group plans to adopt these pronouncements when they become effective.

- IFRS 9 *Financial Instruments* will not be effective before 2017 annual periods. The new standard is to be issued in phases and is intended ultimately to replace International Financial Reporting Standard IAS 39 *Financial Instruments: Recognition and Measurement*. The first phase of IFRS 9 was issued in November 2009 and relates to the classification and measurement of financial assets. The second phase regarding classification and measurement of financial liabilities was published in October 2010. The third phase of IFRS 9 was issued in November 2013 and relates to general hedge accounting.

3 Significant accounting policies, continued

(o) New standards and interpretations not yet adopted, continued

The Group recognises that the new standard introduces many changes to the accounting for financial instruments and is likely to have a significant impact on the consolidated financial statements. The impact of these changes will be analysed during the course of the project as further phases of the standard are issued. The Group does not intend to adopt this standard early. The Group has not yet analysed the likely impact of the new standard on its financial position or performance.

- Amendments to IAS 32 *Financial Instruments: Presentation - Offsetting Financial Assets and Financial Liabilities* do not introduce new rules for offsetting financial assets and liabilities; rather they clarify the offsetting criteria to address inconsistencies in their application. The Amendments specify that an entity currently has a legally enforceable right to set-off if that right is not contingent on a future event; and enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all counterparties. The amendments are effective for annual periods beginning on or after 1 January 2014, and are to be applied retrospectively. The Group has not yet analysed the likely impact of the new standard on its financial position or performance.
- Various *Improvements to IFRS* are dealt with on a standard-by-standard basis. All amendments, which result in accounting changes for presentation, recognition or measurement purposes, will come into effect not earlier than 1 January 2014. The Group has not yet analysed the likely impact of the improvements on its financial position or performance.

4 Net interest income

	2013 AZN'000	2012 AZN'000
Interest income		
Loans to customers	22,822	18,700
Loans to banks	479	238
Available-for-sale financial assets	32	92
Cash and cash equivalents	12	22
	23,345	19,052
Interest expense		
Current accounts and deposits from customers	8,087	7,210
Other borrowed funds	2,229	1,834
Deposits and balances from banks	1,410	684
	11,726	9,728
	11,619	9,324

Included within various line items under interest income for the year ended 31 December 2013 is a total of AZN 2,388 thousand (2012: AZN 2,029 thousand) accrued on impaired financial assets.

5 Fee and commission income

	2013 AZN'000	2012 AZN'000
Cash withdrawal	2,290	1,863
Annual credit card maintenance	462	428
Servicing customers accounts	362	356
Guarantee and letter of credit issuance	250	370
Foreign exchange	180	278
Settlement	4	3
Other	12	2
	3,560	3,300

6 Fee and commission expense

	2013 AZN'000	2012 AZN'000
Cash collection	288	157
Annual credit card maintenance	216	191
Servicing corresponding accounts	103	99
Guarantee and letter of credit issuance	9	43
Other	24	20
	640	510

7 Personnel expenses

	2013 AZN'000	2012 AZN'000
Employee compensation	4,240	3,235
Payments to Social Security Fund	922	707
	5,162	3,942

8 Other general administrative expenses

	2013 AZN'000	2012 AZN'000
Advertising and marketing	1,104	953
Depreciation and amortization (Note 14)	790	693
Security	312	290
Operating lease expense	310	222
Communications and information services	259	239
Repairs and maintenance	199	159
Office supplies	155	131
Professional services	134	246
Taxes other than on income	83	135
Travel expenses	75	40
Insurance	47	35
Utilities	41	51
Other	262	351
	3,771	3,545

9 Income tax expense

	2013 AZN'000	2012 AZN'000
Current year tax expense	937	775
Movement in deferred tax assets and liabilities due to origination and reversal of temporary differences and movement in valuation allowance	30	52
Total income tax expense	967	827

In 2013, the applicable tax rate for current and deferred tax is 20% (2012: 20%).

Reconciliation of effective tax rate for the year ended 31 December:

	2013 AZN'000	%	2012 AZN'000	%
Profit before tax	4,781		4,013	
Income tax at the applicable tax rate	956	20	803	20
Non-deductible costs	11	0	29	1
Non-taxable income	-	-	(5)	-
	967	20	827	21

9 Income tax expense, continued

(a) Deferred tax assets and liabilities

Differences between IFRS and the Azerbaijani statutory taxation rules give rise to net deferred tax liabilities as at 31 December 2013 and 2012.

Movements in temporary differences during the years ended 31 December 2013 and 2012 are presented as follows.

2013	Balance 1 January 2013	Recognised in profit or loss	Recognised in other comprehensive income	Balance 31 December 2013
Available-for-sale financial assets	(5)	-	(10)	(15)
Loans to customers	491	90	-	581
Property and equipment	(457)	(153)	(164)	(774)
Other assets	(55)	27	-	(28)
Other liabilities	(6)	6	-	-
	(32)	(30)	(174)	(236)

2012	Balance 1 January 2012	Recognised in profit or loss	Recognised in other comprehensive income	Balance 31 December 2012
Available-for-sale financial assets	-	-	(5)	(5)
Loans to customers	484	7	-	491
Property and equipment	(428)	(29)	-	(457)
Other assets	(14)	(41)	-	(55)
Other liabilities	(17)	11	-	(6)
	25	(52)	(5)	(32)

(b) Income tax recognised in other comprehensive income

The tax effects relating to components of other comprehensive income for the years ended 31 December 2013 and 2012 comprise the following:

AZN'000	2013			2012		
	Amount before tax	Tax expense	Amount net-of-tax	Amount before tax	Tax expense	Amount net-of-tax
Net change in fair value of available-for-sale financial assets	48	(10)	38	25	(5)	20
Revaluation of property and equipment	824	(164)	660	-	-	-
Other comprehensive income	872	(174)	698	25	(5)	20

10 Cash and cash equivalents

	2013 AZN'000	2012 AZN'000
Cash on hand	16,568	8,850
Nostro accounts with the CBAR	7,844	13,886
Nostro accounts with other banks		
- rated AAA	4,491	2,361
- rated A- to A+	10,942	9,447
- rated BBB	67	2
- rated from BB- to BB+	28	264
- rated below B+	69	1,195
- not rated	542	300
Total nostro accounts with other banks	16,139	13,569
Total cash and cash equivalents	40,551	36,305

No cash and cash equivalents are impaired or past due.

As at 31 December 2013 the Group has two banks (2012: two banks), whose balances exceed 10% of equity. The gross value of these balances as at 31 December 2013 is AZN 14,956 thousand (2012: AZN 19,846 thousand).

11 Available-for-sale financial assets

	2013 AZN'000	2012 AZN'000
Debt and other fixed-income instruments		
- Government and municipal bonds		
Notes issued by Azerbaijan Mortgage Fund	-	337
Treasury bills of the Ministry of Finance of the Republic of Azerbaijan	-	202
Total government and municipal bonds	-	539
Equity investments		
- Corporate shares at cost	1,158	1,110
Total corporate shares	1,158	1,649

Notes issued by Mortgage Fund of the Republic of Azerbaijan and treasury bills of the Ministry of Finance of the Republic of Azerbaijan are stated at fair value calculated based on quoted market price on the Baku Stock Exchange on the reporting date, which is not considered as an active market.

11 Available-for-sale financial assets, continued

Investments without a determinable fair value

Available-for-sale investments stated at cost comprise unquoted equity securities in the Banking, Insurance and Card processing industries. There is no market for these investments and there have not been any recent transactions that provide evidence of the current fair value. In addition, discounted cash flow techniques yield a wide range of fair values due to the uncertainty regarding future cash flows in this industry. However, management believes it unlikely that the fair value at the year end would differ significantly from that carrying amount.

The Bank sold notes issued by Azerbaijan Mortgage Fund and treasury bills of the Ministry of Finance of the Republic of Azerbaijan during the year ended 31 December 2013 that had been accounted for as an available-for-sale investment security (2012: investment in Azerbaijan Mortgage Fund, Ministry of Finance of the Republic of Azerbaijan and in CBAR). The proceeds received on the sale of the investment are AZN 539 thousand (2012: AZN 6,753 thousand).

12 Loans to banks

	2013 AZN'000	2012 AZN'000
Mandatory reserve with the CBAR	3,076	2,803
Loans and deposits		
rated AAA	4,688	-
rated from BB- to BB+	8	8
not rated	4,616	4,404
Total loans and deposits	12,388	7,215

No loans and advances to banks are past due or impaired (2012: no past due or impaired).

As at 31 December 2013, placements with four local banks (2012: three) in the amount of AZN 145 thousand (2012: AZN 139 thousand) and nil annual interest rate (2012: nil) are blocked accounts.

(a) Concentration of loans to banks

As at 31 December 2013 the Group has no banks (2012: no banks), whose balances exceed 10% of equity.

(b) Mandatory reserve with the CBAR

The mandatory reserve deposit is a non-interest bearing deposit calculated in accordance with regulations issued by the CBAR and whose withdrawability is restricted.

13 Loans to customers

	2013 AZN'000	2012 AZN'000
Loans to corporate customers		
Loans to large corporate	45,702	47,987
Loans to small and medium size companies	20,639	26,409
Total loans to corporate customers	66,341	74,396
Loans to retail customers		
Loans to entrepreneurs	68,142	58,291
Consumer loans	29,995	22,790
Mortgage loans	22,304	12,320
Other loans	1,311	1,999
Total loans to retail customers	121,752	95,400
Gross loans to customers	188,093	169,796
Impairment allowance	(10,485)	(8,517)
Net loans to customers	177,608	161,279

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2013 are as follows:

	Loans to corporate customers AZN'000	Loans to retail customers AZN'000	Total AZN'000
Balance at the beginning of the year	4,480	4,037	8,517
Net charge	946	1,022	1,968
Balance at the end of the year	5,426	5,059	10,485

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2012 are as follows:

	Loans to corporate customers AZN'000	Loans to retail customers AZN'000	Total AZN'000
Balance at the beginning of the year	4,593	2,360	6,953
Net charge (recovery)	(113)	1,672	1,559
Write-offs	-	5	5
Balance at the end of the year	4,480	4,037	8,517

13 Loans to customers, continued

The following table provides information by types of loan products as at 31 December 2013:

	Gross amount AZN'000	Impairment allowance AZN'000	Carrying amount AZN'000
Loans to corporate customers:			
Loans to large corporates	45,702	373	45,329
Loans to small and medium size companies	20,639	5,053	15,586
Loans to retail customers:			
Loans to entrepreneurs	68,142	4,001	64,141
Consumer loans	29,995	984	29,011
Mortgage loans	22,304	74	22,230
Other loans	1,311	-	1,311
Total loans to customers	188,093	10,485	177,608

The following table provides information by types of loan products as at 31 December 2012:

	Gross amount AZN'000	Impairment allowance AZN'000	Carrying amount AZN'000
Loans to corporate customers:			
Loans to large corporates	47,987	1,122	46,865
Loans to small and medium size companies	26,409	3,358	23,051
Loans to retail customers:			
Loans to entrepreneurs	58,291	3,111	55,180
Consumer loans	22,790	926	21,864
Mortgage loans	12,320	-	12,320
Other loans	1,999	-	1,999
Total loans to customers	169,796	8,517	161,279

13 Loans to customers, continued

(a) Credit quality of loans to customers

The following table provides information on the credit quality of loans to customers as at 31 December 2013:

	Gross loans AZN'000	Impairment allowance AZN'000	Net loans AZN'000	Impairment allowance to gross loans, %
Loans to corporate customers				
Loans to large corporates				
Loans without individual signs of impairment	44,453	323	44,130	1
Overdue or impaired loans:				
- overdue less than 90 days	1,249	50	1,199	4
Total overdue or impaired loans	1,249	50	1,199	4
Total loans to large corporates	45,702	373	45,329	1
Loans to small and medium size companies				
Loans without individual signs of impairment	13,666	84	13,582	1
Overdue or impaired loans:				
- not overdue	1	1	-	100
- overdue less than 90 days	1,183	811	372	69
- overdue more than 90 days and less than 1 year	627	374	253	60
- overdue more than 1 year	5,162	3,783	1,379	73
Total overdue or impaired loans	6,973	4,969	2,004	71
Total loans to small and medium size companies	20,639	5,053	15,586	24
Total loans to corporate customers	66,341	5,426	60,915	8
Loans to retail customers				
Loans to entrepreneurs				
Loans without individual signs of impairment	60,500	1,289	59,211	2
Overdue or impaired loans:				
- not overdue	2,872	709	2,163	25
- overdue more than 90 days and less than 1 year	1,158	449	709	39
- overdue more than 1 year	3,612	1,554	2,058	43
Total overdue or impaired loans	7,642	2,712	4,930	35
Total loans to entrepreneurs	68,142	4,001	64,141	6
Consumer loans				
Loans without individual signs of impairment	28,727	206	28,521	1
Overdue or impaired loans:				
- not overdue	4	2	2	50
- overdue less than 90 days	29	28	1	97
- overdue more than 90 days and less than 1 year	383	198	185	52
- overdue more than 1 year	852	550	302	65
Total overdue or impaired loans	1,268	778	490	61
Total consumer loans	29,995	984	29,011	3
Mortgage loans				
Loans without individual signs of impairment	22,220	44	22,176	-
Overdue or impaired loans:				
- overdue more than 90 days and less than 1 year	77	23	54	30
- overdue more than 1 year	7	7	-	100
Total overdue or impaired loans	84	30	54	36
Total mortgage loans	22,304	74	22,230	-

13 Loans to customers, continued

(a) Credit quality of loans to customers, continued

	Gross loans AZN'000	Impairment allowance AZN'000	Net loans AZN'000	Impairment allowance to gross loans, %
Other loans				
Loans without individual signs of impairment	1,311	-	1,311	-
Total other loans	1,311	-	1,311	-
Total loans to retail customers	121,752	5,059	116,693	4
Total loans to customers	188,093	10,485	177,608	6

The following table provides information on the credit quality of the loans to customers as at 31 December 2012:

	Gross loans AZN'000	Impairment allowance AZN'000	Net loans AZN'000	Impairment allowance to gross loans, %
Loans to corporate customers				
Loans to large corporates				
Loans without individual signs of impairment	47,987	1,122	46,865	2
Total loans to large corporates	47,987	1,122	46,865	2
Loans to small and medium size companies				
Loans without individual signs of impairment	20,345	426	19,919	2
Overdue or impaired loans:				
- not overdue	322	171	151	53
- overdue more than 90 days and less than 1 year	354	73	281	21
- overdue more than 1 year	5,388	2,688	2,700	50
Total overdue or impaired loans	6,064	2,932	3,132	48
Total loans to small and medium size	26,409	3,358	23,051	13
Total loans to corporate customers	74,396	4,480	69,916	6
Loans to retail customers				
Loans to entrepreneurs				
Loans without individual signs of impairment	51,851	1,090	50,761	2
Overdue or impaired loans:				
- not overdue	1,843	465	1,378	25
- overdue less than 90 days	642	-	642	-
- overdue more than 90 days and less than 1 year	1,183	265	918	22
- overdue more than 1 year	2,772	1,291	1,481	47
Total overdue or impaired loans	6,440	2,021	4,419	31
Total loans to entrepreneurs	58,291	3,111	55,180	5
Consumer loans				
Loans without individual signs of impairment	21,645	247	21,398	1
Overdue or impaired loans:				
- overdue more than 90 days and less than 1 year	61	32	29	52
- overdue more than 1 year	1,084	647	437	60
Total overdue or impaired loans	1,145	679	466	59
Total consumer loans	22,790	926	21,864	4

13 Loans to customers, continued

(a) Credit quality of loans to customers, continued

	Gross loans	Impairment allowance	Net loans	Impairment allowance to gross loans,
	AZN'000	AZN'000	AZN'000	%
Mortgage loans				
Loans without individual signs of impairment	12,313	-	12,313	-
Overdue or impaired loans:				
- overdue more than 90 days and less than 1 year	7	-	7	-
Total overdue or impaired loans	7	-	7	-
Total mortgage loans	12,320	-	12,320	-
Other loans				
Loans without individual signs of impairment	1,999	-	1,999	-
Total other loans	1,999	-	1,999	-
Total loans to retail customers	95,400	4,037	91,363	4
Total loans to customers	169,796	8,517	161,279	5

As at 31 December 2013 included in the loan portfolio are renegotiated loans to customers that would otherwise be past due or impaired of AZN 2,524 thousand (2012: AZN 2,038 thousand). Such restructuring activity is aimed at managing customer relationships and maximising collection opportunities. Renegotiated loans are included in the category of assets without individual signs of impairment in the tables above, unless the borrower fails to comply with the renegotiated terms.

(b) Key assumptions and judgments for estimating the loan impairment

Loan impairment results from one or more events that occurred after the initial recognition of the loan and that have an impact on the estimated future cash flows associated with the loan, and that can be reliably estimated. Loans without individual signs of impairment do not have objective evidence of impairment that can be directly attributed to them.

Within its loan portfolio, the Group separates its customers into customers with total gross loan balances outstanding of AZN 100,000 or more ("significant customers") and customers with total gross loan balances outstanding of less than AZN 100,000 ("other customers"). For significant customers, objective indicators of loan impairment include the following:

- overdue payments under the loan agreement;
- significant difficulties in the financial conditions of the borrower;
- deterioration in business environment, negative changes in the borrower's markets.

For other customers, objective indicators of loan impairment include the following:

- overdue payments under the loan agreement.

The Group estimates loan impairment for loans to significant corporate and retail customers based on an analysis of the future cash flows for loans with individual sign of impairment and based on its past loss experience for portfolios of loans for which no indications of impairment have been identified. Estimation of loan impairment for loans to other corporate and retail customers with or without indications of impairment is also based on past loss experience.

13 Loans to customers, continued

(b) Key assumptions and judgments for estimating the loan impairment, continued

In determining the impairment allowance for loans to significant corporate and retail customers which have no impairment indication and for loans to other corporate and retail customers which have impairment indications and which gross loan balances outstanding of less than AZN 100,000, management makes the following key assumptions:

- historic loss rates are constant and can be estimated based on loss rate history for the past 48 months.

For valuation of the loans to significant customers which have indications of impairment, the following assumptions are made:

- a discount of between 30% and 50% to the originally appraised value if the property pledged is sold;
- a delay of 12 to 36 months in obtaining proceeds from the foreclosure of collateral.

Changes in these estimates could effect the loan impairment provision. For example, to the extent that the net present value of the estimated cash flows differs by one percent, the impairment allowance on loans to customers as at 31 December 2013 would be AZN 1,776 thousand lower/higher (2012: AZN 1,613 thousand lower/higher).

(c) Analysis of collateral and other credit enhancements

The following table provides an analysis of loans to customers, net of impairment, by types of collateral as at 31 December 2013 and 2012:

	2013 AZN`000	% of loan portfolio	2012 AZN`000	% of loan portfolio
Real estate	107,226	60	94,991	59
Guarantee letters	21,154	12	17,309	11
Motor vehicles	7,264	4	6,089	4
Cash and deposits	6,428	4	6,147	4
Equipment	2,591	2	7,444	4
Securities	2,096	1	1,090	1
Jewellery	1,443	1	2,338	1
Other collateral	7,558	4	6,594	4
No collateral or other credit enhancement	21,848	12	19,277	12
	177,608	100	161,329	100

(i) Loans to corporate customers

Loans to corporate customers are subject to individual credit appraisal and impairment testing. The general creditworthiness of a corporate customer tends to be the most relevant indicator of credit quality of the loan extended to it. However, collateral provides additional security and the Group generally requests corporate borrowers to provide it.

13 Loans to customers, continued

(c) Analysis of collateral and other credit enhancements, continued

(i) Loans to corporate customers, continued

The following tables provides information on collateral and other credit enhancements securing loans to corporate customers, net of impairment, by types of collateral:

31 December 2013 AZN'000	Loans to customers, carrying amount	Fair value of collateral – for collateral assessed as of loan inception date
Loans without individual signs of impairment		
Cash and deposits	1,615	1,248
Real estate	44,027	41,739
Motor vehicles	28	28
Equipment	1,868	1,868
Other collateral (Inventory)	3,231	3,216
Guarantee letters	974	-
Securities	2,026	-
No collateral or other credit enhancement	3,943	-
Total loans without individual signs of impairment	57,712	48,099
Overdue or impaired loans		
Real estate	2,701	2,682
Motor vehicles	394	250
Securities	70	-
Total overdue or impaired loans	3,203	2,932
Total loans to corporate customers	60,915	51,031

31 December 2012 AZN'000	Loans to customers, carrying amount	Fair value of collateral – for collateral assessed as of loan inception date
Loans without individual signs of impairment		
Cash and deposits	1,471	1,471
Real estate	47,592	44,480
Motor vehicles	44	44
Equipment	5,369	4,382
Other collateral (Inventory)	5,428	4,555
Guarantee letters	731	-
Securities	1,026	-
No collateral or other credit enhancement	5,123	-
Total loans without individual signs of impairment	66,784	54,932
Overdue or impaired loans		
Real estate	1,442	1,401
Motor vehicles	88	88
Equipment	664	664
Guarantee letters	132	-
Securities	64	-
No collateral or other credit enhancement	742	-
Total overdue or impaired loans	3,132	2,153
Total loans to corporate customers	69,916	57,085

13 Loans to customers, continued

(c) Analysis of collateral and other credit enhancements, continued

(i) Loans to corporate customers, continued

The tables above exclude overcollateralization.

The Group has loans, for which fair value of collateral was assessed at the loan inception date and it was not updated for further changes, and loans for which fair value of collateral is not determined. Information on valuation of collateral is based on when this estimate was made, if any.

For loans secured by multiple types of collateral, collateral that is most relevant for impairment assessment is disclosed. Sureties received from individuals, such as shareholders of SME borrowers, are not considered for impairment assessment purposes. Accordingly, such loans and unsecured portions of partially secured exposures are presented as loans without collateral or other credit enhancement.

The recoverability of loans which are neither past due nor impaired is primarily dependent on the creditworthiness of the borrowers rather than the value of collateral, and the Group does not necessarily update the valuation of collateral as at each reporting date.

(ii) Loans to entrepreneurs

The following tables provides information on collateral and other credit enhancements securing loans to entrepreneurs, net of impairment, by types of collateral:

31 December 2013 AZN'000	Loans to customers, carrying amount	Fair value of collateral - for collateral assessed as of inception date
Loans without individual signs of impairment		
Cash and deposits	379	375
Real estate	35,075	34,613
Motor vehicles	892	892
Equipment	367	349
Other collateral (Inventory)	3,521	3,405
Jewellery	175	126
Guarantee letters	4,329	-
No collateral or other credit enhancement	14,473	-
Total loans without individual signs of impairment	59,211	39,760
Overdue or impaired loans		
Real estate	3,148	2,467
Motor vehicles	1,059	1,058
Equipment	105	105
Other collateral (Inventory)	8	8
Jewellery	1	1
Guarantee letters	19	-
No collateral or other credit enhancement	590	-
Total overdue or impaired loans	4,930	3,639
Total loans to entrepreneurs	64,141	43,399

13 Loans to customers, continued

(c) Analysis of collateral and other credit enhancements, continued

(ii) Loans to entrepreneurs, continued

31 December 2012 AZN'000	Loans to customers, carrying amount	Fair value of collateral - for collateral assessed as of inception date
Loans without individual signs of impairment		
Cash and deposits	1,944	1,925
Real estate	31,204	29,792
Motor vehicles	1,569	1,569
Equipment	580	579
Other collateral (Inventory)	993	992
Jewellery	121	115
Guarantee letters	1,774	-
No collateral or other credit enhancement	12,576	-
Total loans without individual signs of impairment	50,761	34,972
Overdue or impaired loans		
Real estate	2,424	2,244
Motor vehicles	1,056	1,056
Equipment	108	108
Jewellery	3	3
Other collateral (Inventory)	3	3
Guarantee letters	2	-
No collateral or other credit enhancement	823	-
Total overdue or impaired loans	4,419	3,414
Total loans to entrepreneurs	55,180	38,386

The tables above exclude overcollateralization.

Fair value of collateral was assessed at the loan inception date and it was not updated for further changes for all loans of the Group. Information on valuation of collateral is based on when this estimate was made, if any.

For loans secured by multiple types of collateral, collateral that is most relevant for impairment assessment is disclosed. Sureties received from individuals, such as shareholders of SME borrowers, are not considered for impairment assessment purposes. Accordingly, such loans and unsecured portions of partially secured exposures are presented as loans without collateral or other credit enhancement.

The recoverability of loans which are neither past due nor impaired is primarily dependent on the creditworthiness of the borrowers rather than the value of collateral, and the Group does not necessarily update the valuation of collateral as at each reporting date.

13 Loans to customers, continued

(iii) Loans to other retail customers

Mortgage loans are secured by the underlying housing real estate. The Group's policy is to issue mortgage loans with a loan-to-value ratio at the date of loan issuance of a maximum of 70%.

The following tables provide information on real estate collateral securing mortgage loans, net of impairment:

31 December 2013 AZN'000	Loans to customers, carrying amount	Fair value of collateral – for collateral assessed as of loan inception date
Not overdue loans	22,176	22,162
Overdue loans	54	54
Total mortgage loans	22,230	22,216

31 December 2012 AZN'000	Loans to customers, carrying amount	Fair value of collateral – for collateral assessed as of loan inception date
Not overdue loans	12,313	12,298
Overdue loans	7	7
Total mortgage loans	12,320	12,305

The tables above exclude overcollateralization.

The fair value of collateral was estimated at inception of the loans and was not adjusted for subsequent changes to the reporting date.

65% of the consumers loans are collateralised by guarantee letters and remaining part by cash deposits and jewellery with a loan-to-value ratio of a maximum of 80%.

Auto loans included in consumer loans are secured by the underlying cars. The Group's policy is to issue auto loans with a loan-to-value ratio of a maximum of 70%.

(iv) Repossessed collateral

During the year ended 31 December 2013, the Group obtained certain assets by taking possession of collateral for loans to customers with a gross amount of AZN 22 thousand (2012: AZN 220 thousand). As at 31 December 2013 and 2012, the repossessed collateral comprises:

	2013 AZN'000	2012 AZN'000
Real estate	467	579
Total repossessed collateral	467	579

The Group's policy is to sell these assets as soon as it is practicable.

13 Loans to customers, continued

(d) Industry and geographical analysis of the loan portfolio

Loans to customers were issued primarily to customers located within the Republic of Azerbaijan who operate in the following economic sectors:

	2013	2012
	AZN'000	AZN'000
Trade and services	48,946	54,357
Manufacturing	30,216	30,709
Agriculture, forestry and timber	29,500	18,312
Construction	26,781	24,328
Other	350	6,980
Loans to retail customers	52,300	35,110
	188,093	169,796
Impairment allowance	(10,485)	(8,517)
	177,608	161,279

(e) Significant credit exposures

As at 31 December 2013 the Group has three borrowers or groups of connected borrowers (2012: seven), whose loan balances exceed 10% of equity. The gross value of these loans as at 31 December 2013 is AZN 16,753 thousand (2012: AZN 30,612 thousand).

(f) Loan maturities

The maturity of the loan portfolio is presented in note 23(d), which shows the remaining period from the reporting date to the contractual maturity of the loans.

14 Property, equipment and intangible assets

AZN'000	Buildings	Leasehold improvement	Equipment	Fixtures and fittings	Other fixed assets	Computer software	Total
Cost/revalued amount							
Balance at 1 January 2013	7,794	1,005	954	1,502	417	220	11,892
Additions	583	927	127	358	47	12	2,054
Disposals	-	-	(48)	(66)	(46)	-	(160)
Revaluation	176	-	-	-	-	-	176
Balance at 31 December 2013	8,553	1,932	1,033	1,794	418	232	13,962
Depreciation and amortisation							
Balance at 1 January 2013	(412)	(119)	(528)	(873)	(225)	(124)	(2,281)
Depreciation and amortisation for the year	(240)	(76)	(161)	(227)	(68)	(20)	(790)
Disposals	-	-	47	66	46	-	159
Revaluation	648	-	-	-	-	-	648
Balance at 31 December 2013	(4)	(195)	(642)	(1,034)	(247)	(144)	(2,266)
Carrying amount							
At 31 December 2013	8,549	1,737	391	760	171	88	11,696

14 Property, equipment and intangible assets, continued

AZN'000	Buildings	Leasehold improvement	Equipment	Fixtures and fittings	Other fixed assets	Computer software	Total
Cost/revalued amount							
Balance at 1 January 2012	6,842	625	600	1,309	373	178	9,927
Additions	952	380	366	271	48	48	2,065
Disposals	-	-	(12)	(78)	(4)	(6)	(100)
At 31 December 2012	7,794	1,005	954	1,502	417	220	11,892
Depreciation and amortisation							
Balance at 1 January 2012	(206)	(66)	(422)	(747)	(135)	(110)	(1,686)
Depreciation and amortisation for the year	(206)	(53)	(118)	(202)	(94)	(20)	(693)
Disposals	-	-	12	76	4	6	98
Balance at 31 December 2012	(412)	(119)	(528)	(873)	(225)	(124)	(2,281)
Carrying amounts							
At 31 December 2012	7,382	886	426	629	192	96	9,611

There are no capitalised borrowing costs related to the acquisition or construction of property and equipment during 2013 (2012: nil).

14 Property, equipment and intangible assets, continued

(a) Revalued assets

The fair values of the Group's buildings are categorised into Level 3 of the fair value hierarchy which was determined as at 31 December 2013.

At 31 December 2013 buildings are revalued based on the results of an independent appraisal performed by "Real Prays" LLC.

The basis used for the appraisal is the market approach. The market approach is based upon an analysis of the results of comparable sales of similar buildings.

The values assigned to the key assumptions represent management's assessment of future business trends and are based on both external sources and internal sources of information.

The carrying value of buildings as at 31 December 2013, if the buildings would not have been revalued, would be AZN 5,329 thousand (2012: AZN 5,569 thousand).

15 Other assets

	2013 AZN'000	2012 AZN'000
Other receivables	129	106
Total other financial assets	129	106
Repossessed collateral	186	579
Prepayments	467	158
Tax settlements, other than income tax	67	68
Sundry receivables	51	45
Other	36	58
Total other non-financial assets	807	908
Total other assets	936	1,014

16 Deposits and balances from banks

	2013 AZN'000	2012 AZN'000
Vostro accounts	4	319
Term deposits	27,134	25,212
	27,138	25,531

As at 31 December 2013 the Group has two banks (2012: three banks), whose balances exceed 10% of equity. The gross value of these balances as at 31 December 2013 are AZN 22,934 thousand (2012: AZN 18,649 thousand).

17 Current accounts and deposits from customers

	2013 AZN'000	2012 AZN'000
Current accounts and demand deposits		
- Retail	18,776	8,133
- Corporate	13,435	32,914
Term deposits		
- Retail	63,452	49,681
- Corporate	12,504	12,032
	108,167	102,760

As at 31 December 2013, the Group maintained customer deposit balances of AZN 11,735 thousand (2012: AZN 9,873 thousand) that serve as collateral for loans and unrecognized credit instruments granted by the Group.

As at 31 December 2013, the Group has one customer (2012: three customers), whose balances exceed 10% of equity. These balances as at 31 December 2013 are AZN 9,801 thousand (2012: AZN 37,280 thousand).

18 Other borrowed funds

	2013 AZN'000	2012 AZN'000
Funds borrowed from the National Fund for Support of Entrepreneurship of the Republic of Azerbaijan	22,760	22,440
Funds borrowed from Azerbaijan Mortgage Fund	14,040	9,735
Funds borrowed from the State Agency for Agricultural Credits	8,870	5,385
Funds borrowed from Islamic Cooperation for Development of the Private Sector (ICDPS)	4,088	3,131
Funds borrowed from International Finance Corporation (IFC)	3,626	5,436
Funds borrowed from Black Sea Trade and Development Bank	3,245	3,301
Funds borrowed from World Business Capital Inc (WBC)	3,165	3,761
Funds borrowed from International Fund for Agricultural development (IFAD)	168	3,010
	59,962	56,199

In September 2002, the Group signed an agreement with the National Fund for Support of Entrepreneurship of the Republic of Azerbaijan as part of a programme under the auspices of the Ministry for Economic Development of the Republic of Azerbaijan for financing of small and medium size enterprises. Under this programme, from time to time funds are made available to the Group at an interest rate of 1.0%-2.0% per annum and the Group lends these funds on to eligible borrowers at rates not higher than 7.0%-8.0% per annum. As at 31 December 2013 the Group has AZN 22,760 thousand (31 December 2012: AZN 22,440 thousand) payable to the fund, repayable up to 30 December 2018. The borrowing agreement does not include any financial covenants.

18 Other borrowed funds, continued

On 17 February 2006, the Group signed an agreement with the Azerbaijan Mortgage Fund as part of a programme under the auspices of CBAR, on initial financing of mortgage loans to individuals. Under this programme, from time to time funds are made available to the Group at an interest rate of 2-8% per annum and the Group lends these funds on to eligible borrowers at a rate 8.0% per annum. As at 31 December 2013 the Group has AZN 14,040 thousand (31 December 2012: AZN 9,735 thousand) payable to the Fund. The borrowing agreement does not include any financial covenants.

On 30 July 2007, the Group signed an agreement with the State Agency for Agricultural Credits as part of a programme under the auspices of the Ministry for Agriculture of the Republic of Azerbaijan, for financing of small and medium size enterprises. Under this programme, from time to time funds are made available to the Group at an interest rate of 2.0% per annum and the Group lends these funds on to eligible borrowers at rates not higher than 7.0% per annum. As at 31 December 2013 the Group has AZN 8,870 thousand (31 December 2012: AZN 5,385 thousand) payable to the Agency that is repayable from 2012 to 2014. The borrowing agreement does not include any financial covenants.

On 2 April 2008, the Group signed a revolving loan agreement with ICDPS on obtaining a credit line up to USD 1,000 thousand to be used for financing small and medium-sized enterprises of the Republic of Azerbaijan. In 2011 another credit line for USD 1,000 thousand was obtained from ICDPS. As at 31 December 2013, the outstanding amount under both credit agreements was AZN 4,088 thousand (31 December 2012: AZN 3,131 thousand) that is repayable from 2013 to 2017. Interest is charged on ICDPS borrowings at 5 years USD Swap rate plus 700 basis points per annum with a floor of 9% and a cap of 12% per annum. The Group is obliged to comply with certain financial covenants stipulated by the aforementioned loan agreement.

On 27 May 2011, the Group signed a credit agreement with IFC to obtain a loan of USD 7,000 thousand maturing on 25 December 2015 to be used for financing the growth of its microfinance and small and medium enterprise portfolio. As at 31 December 2013, the outstanding amount of debt under this credit agreement was AZN 3,626 thousand (31 December 2012: AZN 5,436 thousand) at an interest rate of 6.06% per annum. The Group is obliged to comply with certain financial covenants stipulated by the aforementioned loan agreement.

On 5 December 2011, the Group signed a credit agreement with Black Sea Trade and Development Bank to obtain a revolving credit line in the amount of USD 4,000 thousand maturing on 22 July 2017 to be used for financing customers in the Republic of Azerbaijan who export goods to other Member or non-Member Countries and/or import goods from other Member Countries. As at 31 December 2013, the outstanding amount of debt under this credit agreement was AZN 3,245 thousand (31 December 2012 : AZN 3,301 thousand) at an interest rate of 9% per annum. The Group is obliged to comply with certain financial covenants stipulated by the aforementioned loan agreement.

On 29 June 2009, the Group signed a loan agreement with WBC to obtain a credit line of up to USD 7,500 thousand to be used for financing small and medium-sized enterprises of the Republic of Azerbaijan. As at 31 December 2013, the Group had drawn down credit in the amount of AZN 3,165 thousand (31 December 2012: AZN 3,761 thousand) at an interest rate of 3.8125% (3 month LIBOR plus 3.5%) per annum. The maturity date of the loan agreement is 25 June 2019. The Group is obliged to comply with certain financial covenants stipulated by the aforementioned loan agreement.

18 Other borrowed funds, continued

On 12 October 2004, the Group signed an agreement with IFAD as part of a programme under the auspices of the Ministry for Agriculture of the Republic of Azerbaijan for financing of small and medium size enterprises of the Republic of Azerbaijan. As at 31 December 2013, the Group had total borrowings of AZN 168 thousand (31 December 2012: AZN 2,111 thousand and USD 1,126 thousand) from IFAD that is repayable from 2012 to 2014. Interest is charged on IFAD borrowings from 2-6% depending on the specific project for which the loan is made. The borrowing agreement does not include any financial covenants.

(a) Breach of covenants

As at 31 December 2013, the Group was in compliance with all the financial covenants set by financial institutions mentioned above.

19 Other liabilities

	2013 AZN'000	2012 AZN'000
Amounts in course of settlement	245	122
Payables on securities settlements	-	5
Other financial liabilities	26	31
Total other financial liabilities	271	158
Provision for guarantees and letters of credit issued	-	148
Other non-financial liabilities	47	46
Total other non-financial liabilities	47	194
Total other liabilities	318	352

20 Share capital and reserves

(a) Issued capital and share premium

The authorised, issued and outstanding share capital comprises 40,667 ordinary shares (2012: 27,727). All shares have a nominal value of AZN 1,082 per share. During 2013, 12,940 ordinary shares (2012: 5,727) were issued. Of these issued shares, 2,772 were settled through a transfer from retained earnings of AZN 3,000 thousand and the remaining part was paid for in cash with a total value of AZN 11,001 thousand.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at annual and general meetings of the Bank.

(b) Nature and purpose of reserves

Revaluation surplus for buildings

The revaluation surplus for buildings comprises the cumulative positive revalued value of buildings, until the assets are derecognised or impaired.

Revaluation reserve for available-for-sale financial assets

The revaluation reserve for available-for-sale financial assets comprises the cumulative net change in the fair value, until the assets are derecognised or impaired.

(c) Dividends

Dividends payable are restricted to the maximum statutory retained earnings of the Group, which are determined according to the legislation of the Republic of Azerbaijan. Banks are not allowed to pay dividends if net assets are less than share capital. Reserves available for distribution amounted to AZN 4,332 thousand as at 31 December 2013 (2012: AZN 3,220 thousand).

At the reporting date the following dividends and other distributions were declared and are therefore accrued as follows:

	2013 AZN	2012 AZN
Dividends per ordinary share (in AZN)	-	65
Other distributions per ordinary share (in AZN)	108	82

21 Earnings per share

(a) Basic earnings per share

	2013 AZN'000	2012 AZN'000
Earnings per share		
Basic earnings per share (AZN per share)	112	138

(b) Basic earnings per share

The calculation of basic earnings per share as at 31 December 2013 is based on the profit attributable to ordinary shareholders of AZN 3,814 thousand (2012: AZN 3,186 thousand), and a weighted average number of ordinary shares outstanding of 34,027 (2012: 23,015) calculated as follows.

	2013 AZN'000	2012 AZN'000
Net profit attributable to ordinary shareholders	3,814	3,186
Issued ordinary shares at the beginning of the year	27,727	22,000
Effect of shares issued during the year	6,300	1,015
Weighted average number of ordinary shares for the year ended 31 December	34,027	23,015
Earnings per share (AZN)	112	138

22 Analysis by segment

Management believes that the Group has one reportable segment and one strategic business unit which includes loans, deposits, financial leasing and other transactions with customers for the year ended 31 December 2013 (2012: one).

The majority of income from external customers relates to residents of the Republic of Azerbaijan.

The majority of non-current assets are located in the Republic of Azerbaijan.

23 Risk management

Management of risk is fundamental to the business of banking and is an essential element of the Group's operations. The major risks faced by the Group are those related to market risk, credit risk and liquidity risk.

(a) Risk management policies and procedures

The risk management policies aim to identify, analyse and manage the risks faced by the Group, to set appropriate risk limits and controls, and to continuously monitor risk levels and adherence to limits. Risk management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and emerging best practice.

The Supervisory Board has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing its risk management policies and procedures as well as approving significantly large exposures.

The Management Board is responsible for monitoring and implementation of risk mitigation measures and making sure that the Group operates within the established risk parameters. The Head of the Risk Department is responsible for the overall risk management and compliance functions, ensuring the implementation of common principles and methods for identifying, measuring, managing and reporting both financial and non-financial risks. He reports directly to the CEO and indirectly to the Supervisory Board.

Credit, market and liquidity risks both at the portfolio and transactional levels are managed and controlled through a system of Credit Committees and an Asset and Liability Management Committee (ALCO). In order to facilitate efficient and effective decision-making, the Group established a hierarchy of credit committees depending on the type and amount of the exposure.

Both external and internal risk factors are identified and managed throughout the organisation. Particular attention is given to identifying the full range of risk factors and determination of the level of assurance over the current risk mitigation procedures. Apart from the standard credit and market risk analysis, the Risk Department monitors financial and non-financial risks by holding regular meetings with operational units in order to obtain expert judgments in their areas of expertise.

(b) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises currency risk, interest rate risk and other price risks. Market risk arises from open positions in interest rate, currency and equity financial instruments, which are exposed to general and specific market movements and changes in the level of volatility of market prices and foreign currency rates.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, whilst optimizing the return on risk.

Overall authority for market risk is vested in the ALCO, which is chaired by the CEO. Market risk limits are approved by ALCO based on recommendations of the Risk Department.

The Group manages its market risk by setting open position limits in relation to financial instruments, interest rate maturity and currency positions and stop-loss limits. These are monitored on a regular basis and reviewed and approved by the Management Board.

23 Risk management, continued

(b) Market risk, continued

(i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may also reduce or create losses in the event that unexpected movements occur.

Interest rate gap analysis

Interest rate risk is managed principally through monitoring interest rate gaps. A summary of the interest gap position for major financial instruments is as follows:

AZN '000	Less than 3 months	3-6 months	6-12 months	1-5 years	More than 5 years	Non- interest bearing	Carrying amount
31 December 2013							
ASSETS							
Cash and cash equivalents	-	-	-	-	-	40,551	40,551
Available-for-sale financial assets	-	-	-	-	-	1,158	1,158
Loans to banks	6,164	1,000	2,000	-	-	3,224	12,388
Loans to customers	21,472	22,505	44,534	74,594	10,826	3,677	177,608
	27,636	23,505	46,534	74,594	10,826	48,610	231,705
LIABILITIES							
Deposits and balances from banks	13,611	4,461	3,000	5,785	-	281	27,138
Current accounts and deposits from customers	24,142	13,184	19,687	28,221	27	22,906	108,167
Other borrowed funds	4,703	7,307	8,927	28,993	9,807	225	59,962
	42,456	24,952	31,614	62,999	9,834	23,412	195,267
	(14,820)	(1,447)	14,920	11,595	992	25,198	36,438

23 Risk management, continued

(b) Market risk, continued

(i) Interest rate risk, continued

Interest rate gap analysis, continued

AZN '000	Less than 3 months	3-6 months	6-12 months	1-5 years	More than 5 years	Non- interest bearing	Carrying amount
31 December 2012							
ASSETS							
Cash and cash equivalents	-	-	-	-	-	36,305	36,305
Available-for-sale financial assets	-	-	-	202	337	1,110	1,649
Loans to banks	3,436	330	-	507	-	2,942	7,215
Loans to customers	20,876	17,970	50,267	60,329	8,249	3,588	161,279
	24,312	18,300	50,267	61,038	8,586	43,945	206,448
LIABILITIES							
Deposits and balances from banks	4,151	5,960	-	14,962	-	458	25,531
Current accounts and deposits from customers	15,920	6,941	15,916	24,153	23	39,807	102,760
Other borrowed funds	12,833	1,487	7,820	25,445	8,380	234	56,199
	32,904	14,388	23,736	64,560	8,403	40,499	184,490
	(8,592)	3,912	26,531	(3,522)	183	3,446	21,958

Average effective interest rates

The table below displays average effective interest rates for interest bearing assets and liabilities as at 31 December 2013 and 2012. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

	2013			2012		
	Average effective interest rate, %			Average effective interest rate, %		
	AZN	USD	Other currencies	AZN	USD	Other currencies
Interest bearing assets						
Available-for-sale financial assets	-	-	-	1.00	-	-
Loans to banks	7.71	0.21	-	8.18	8.33	-
Loans to customers	33.01	15.34	-	13.19	16.40	7.96
Interest bearing liabilities						
Deposits and balances from banks						
- Vostro accounts	-	-	-	-	-	-
- Term deposits	6.64	7.69	3.68	6.52	8.82	4.39
Current accounts and deposits from customers						
- Current accounts and demand deposits	1.85	0.50	0.04	4.55	3.32	4.50
- Term deposits	11.49	13.19	11.96	11.72	13.45	12.28
Other borrowed funds	1.97	6.32	-	1.87	7.16	-

23 Risk management, continued

(b) Market risk, continued

(i) Interest rate risk, continued

Interest rate sensitivity analysis

The management of interest rate risk based on interest rate gap analysis is supplemented by monitoring the sensitivity of financial assets and liabilities. An analysis of sensitivity of net profit or loss and equity (net of taxes) to changes in interest rates (repricing risk) based on a simplified scenario of a 100 basis point (bp) symmetrical fall or rise in all yield curves and positions of interest-bearing assets and liabilities existing as at 31 December 2013 and 2012 is as follows:

	2013 AZN'000	2012 AZN'000
100 bp parallel fall	56	(64)
100 bp parallel rise	(56)	64

(ii) Currency risk

The Group has assets and liabilities denominated in several foreign currencies.

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign currency exchange rates. Although the Group hedges its exposure to currency risk, such activities do not qualify as hedging relationships in accordance with IFRS.

The following table shows the foreign currency exposure structure of financial assets and liabilities as at 31 December 2013:

	AZN AZN'000	USD AZN'000	EUR AZN'000	Other currencies AZN'000	Total AZN'000
ASSETS					
Cash and cash equivalents	17,626	11,726	10,599	600	40,551
Available-for-sale financial assets	1,158	-	-	-	1,158
Loans to banks	7,556	4,832	-	-	12,388
Loans to customers	146,961	30,626	21	-	177,608
Other financial assets	109	20	-	-	129
Total assets	173,410	47,204	10,620	600	231,834
LIABILITIES					
Deposits and balances from banks	15,000	4,186	7,563	389	27,138
Current accounts and deposits from customers	76,023	28,916	3,111	117	108,167
Other borrowed funds	45,516	14,446	-	-	59,962
Other financial liabilities	260	11	-	-	271
Total liabilities	136,799	47,559	10,674	506	195,538
Net position	36,611	(355)	(54)	94	36,296

23 Risk management, continued

(b) Market risk, continued

(ii) Currency risk, continued

The following table shows the currency structure of financial assets and liabilities as at 31 December 2012:

	AZN	USD	EUR	Other currencies	Total
	AZN'000	AZN'000	AZN'000	AZN'000	AZN'000
ASSETS					
Cash and cash equivalents	18,465	9,059	8,281	500	36,305
Available-for-sale financial assets	1,649	-	-	-	1,649
Loans to banks	5,079	2,136	-	-	7,215
Loans to customers	116,576	44,676	27	-	161,279
Other financial assets	77	20	-	9	106
Total assets	141,846	55,891	8,308	509	206,554
LIABILITIES					
Deposits and balances from banks	17,005	3,007	5,519	-	25,531
Current accounts and deposits from customers	56,860	42,081	3,384	435	102,760
Other borrowed funds	39,687	16,512	-	-	56,199
Other financial liabilities	148	10	-	-	158
Total liabilities	113,700	61,610	8,903	435	184,648
Net position	28,146	(5,719)	(595)	74	21,906

A weakening of the AZN, as indicated below, against the following currencies at 31 December 2013 and 2012 would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis is on net of tax basis and is based on foreign currency exchange rate variances that the Group considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

	2013 AZN'000	2012 AZN'000
10% appreciation of USD against AZN	(28)	(458)
10% appreciation of EUR against AZN	(4)	(48)

A strengthening of the AZN against the above currencies at 31 December 2013 and 2012 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

23 Risk management, continued

(c) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Group has policies and procedures for the management of credit exposures (both for recognised financial assets and unrecognised contractual commitments), including guidelines to limit portfolio concentration and the establishment of a Credit Committee, which actively monitors credit risk. The credit policy is reviewed and approved by the Management Board.

The credit policy establishes:

- procedures for review and approval of loan credit applications
- methodology for the credit assessment of borrowers (corporate and retail)
- methodology for the credit assessment of counterparties, issuers and insurance companies
- methodology for the evaluation of collateral
- credit documentation requirements
- procedures for the ongoing monitoring of loans and other credit exposures.

Corporate loan credit applications are originated by the relevant client managers and are then passed on to the Loan Department, which is responsible for the corporate loan portfolio. Analysis reports are based on a structured analysis focusing on the customer's business and financial performance. The loan credit application and the report are then independently reviewed by the Risk Department and a second opinion is given accompanied by a verification that credit policy requirements are met. The Credit Committee reviews the loan credit application on the basis of submissions by the Loan Department and the Risk Department. Individual transactions are also reviewed by the Legal, Accounting and Tax departments depending on the specific risks and pending final approval of the Credit Committee.

The Group continuously monitors the performance of individual credit exposures and regularly reassesses the creditworthiness of its customers. The review is based on the customer's most recent financial statements and other information submitted by the borrower, or otherwise obtained by the Group. Retail loan credit applications are reviewed by the Retail Lending Department through the use of scoring models and application data verification procedures developed together with the Risk Department.

Apart from individual customer analysis, the credit portfolio is assessed by the Risk Department with regard to credit concentration and market risks.

The maximum exposure to credit risk is generally reflected in the carrying amounts of financial assets in the consolidated statement of financial position and unrecognised contractual commitment amounts. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

23 Risk management, continued

(c) Credit risk, continued

The maximum exposure to credit risk from financial assets excluding CBAR balances at the reporting date is as follows:

	2013 AZN'000	2012 AZN'000
ASSETS		
Cash and cash equivalents (excluding CBAR balances)	16,139	13,569
Available-for-sale financial assets	-	539
Loans to banks	12,388	7,215
Loans to customers	177,608	161,279
Other financial assets	129	106
Total maximum exposure	206,264	182,708

Collateral generally is not held against claims under derivative financial instruments, investments in securities, and loans to banks, except when securities are held as part of reverse repurchase and securities borrowing activities.

For the analysis of collateral held against loans to customers and concentration of credit risk in respect of loans to customers refer to note 13.

The maximum exposure to credit risk from unrecognised contractual commitments at the reporting date is presented in note 25.

As at 31 December 2013 the Group has no debtors or groups of connected debtors (2012: none), credit risk exposure to whom exceeds 10% of maximum credit risk exposure.

(d) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to liquidity management. It is unusual for financial institutions ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

The Group maintains liquidity management with the objective of ensuring that funds will be available at all times to honor all cash flow obligations as they become due. The liquidity policy is reviewed and approved by the Management Board.

23 Risk management, continued

(d) Liquidity risk, continued

The Group seeks to actively support a diversified and stable funding base comprising debt securities in issue, long-term and short-term loans from other banks, core corporate and retail customer deposits, accompanied by diversified portfolios of highly liquid assets, in order to be able to respond quickly and smoothly to unforeseen liquidity requirements.

The liquidity management policy requires:

- projecting cash flows by major currencies and considering the level of liquid assets necessary in relation thereto
- maintaining a diverse range of funding sources
- managing the concentration and profile of debts
- maintaining debt financing plans
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any interruption to cash flow
- maintaining liquidity and funding contingency plans
- monitoring liquidity ratios against regulatory requirements.

The Treasury Department receives information from business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. The Treasury Department then provides for an adequate portfolio of short-term liquid assets to be maintained, largely made up of short-term liquid trading securities, loans to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Group as a whole.

The daily liquidity position is monitored and regular liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions is performed by the Treasury Department. Under the normal market conditions, liquidity reports covering the liquidity position are presented to senior management on a weekly basis. Decisions on liquidity management are made by ALCO and implemented by the Treasury Department.

The following tables show the undiscounted cash flows on financial assets, liabilities and credit-related commitments on the basis of their earliest possible contractual maturity. The total gross inflow and outflow disclosed in the tables is the contractual, undiscounted cash flow on the financial assets, liability or credit related commitment. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee can be called.

23 Risk management, continued

(d) Liquidity risk, continued

The maturity analysis for financial assets and liabilities as at 31 December 2013 is as follows:

AZN'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 6 months	From 6 to 12 months	More than 1 year	Total gross amount outflow	Carrying amount
Non-derivative liabilities							
Deposits and balances from banks	6,156	7,939	4,644	3,188	5,974	27,901	27,138
Current accounts and deposits from customers	39,895	6,241	14,898	22,959	33,122	117,115	108,167
Other borrowed funds	1,576	3,616	7,831	9,660	47,003	69,686	59,962
Other financial liabilities	271	-	-	-	-	271	271
Total financial liabilities	47,898	17,796	27,373	35,807	86,099	214,973	195,538
Credit related commitments	34,347	-	-	-	-	34,347	34,347

The maturity analysis for financial assets and liabilities as at 31 December 2012 is as follows:

AZN'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 6 months	From 6 to 12 months	More than 1 year	Total gross amount outflow	Carrying amount
Non-derivative liabilities							
Deposits and balances from banks	320	4,372	6,350	355	15,805	27,202	25,531
Current accounts and deposits from customers	96,619	7,500	971	2,253	4,932	112,275	102,760
Other borrowed funds	13,005	1,720	2,528	8,240	42,053	67,546	56,199
Other financial liabilities	41	-	-	117	-	158	158
Total financial liabilities	109,985	13,592	9,849	9,327	62,790	207,181	184,648
Credit related commitments	26,612	-	-	-	-	26,612	26,612

23 Risk management, continued

(d) Liquidity risk, continued

In accordance with Azerbaijani legislation, individuals and legal entities can withdraw their term deposits at any time, forfeiting in most of the cases the accrued interest. These deposits are classified in accordance with their stated maturity dates.

Management expects that the cash flows from certain financial assets and liabilities will be different from their contractual terms either because management has the discretionary ability to manage the cash flows or because past experience indicates that cash flows will differ from contractual terms.

23 Risk management, continued

(d) Liquidity risk, continued

The table below shows an analysis, by expected maturities, of the amounts recognised in the statement of financial position as at 31 December 2013:

AZN'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	No maturity	Overdue	Total
ASSETS								
Cash and cash equivalents	40,551	-	-	-	-	-	-	40,551
Available-for-sale financial assets	-	-	-	-	-	1,158	-	1,158
Loans to banks	6,167	-	3,000	-	-	3,221	-	12,388
Loans to customers	7,418	13,745	66,372	74,329	10,804	-	4,940	177,608
Property, equipment and intangible assets	-	-	-	-	-	11,696	-	11,696
Other assets	292	67	47	-	-	530	-	936
Total assets	54,428	13,812	69,419	74,329	10,804	16,605	4,940	244,337
LIABILITIES								
Deposits and balances from banks	6,153	7,734	7,461	5,785	-	5	-	27,138
Current accounts and deposits from customers	40,022	5,466	34,059	28,593	27	-	-	108,167
Other borrowed funds	1,503	3,292	16,366	28,993	9,808	-	-	59,962
Current tax liability	-	-	409	-	-	-	-	409
Deferred tax liabilities	-	-	-	-	-	236	-	236
Other liabilities	318	-	-	-	-	-	-	318
Total liabilities	47,996	16,492	58,295	63,371	9,835	241	-	196,230
Net position	6,432	(2,680)	11,124	10,958	969	16,364	4,940	48,107
Cumulative net position up to 5 years	6,432	3,752	14,876	25,834				

23 Risk management, continued

(d) Liquidity risk, continued

The table below shows an analysis, by expected maturities, of the amounts recognised in the statement of financial position as at 31 December 2012:

AZN'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	No maturity	Overdue	Total
ASSETS								
Cash and cash equivalents	36,305	-	-	-	-	-	-	36,305
Available-for-sale financial assets	-	-	-	202	337	1,110	-	1,649
Loans to banks	136	3,300	330	507	-	2,942	-	7,215
Loans to customers	7,618	11,880	68,236	60,329	8,249	-	4,967	161,279
Property, equipment and intangible assets	-	-	-	-	-	9,611	-	9,611
Other assets	263	68	683	-	-	-	-	1,014
Total assets	44,322	15,248	69,249	61,038	8,586	13,663	4,967	217,073
LIABILITIES								
Deposits and balances from banks	320	4,166	6,002	15,043	-	-	-	25,531
Current accounts and deposits from customers	41,343	13,071	23,407	24,916	23	-	-	102,760
Other borrowed funds	12,888	1,487	7,820	25,624	8,380	-	-	56,199
Current tax liability	-	-	-	-	-	329	-	329
Deferred tax liabilities	-	-	32	-	-	-	-	32
Other liabilities	55	-	259	38	-	-	-	352
Total liabilities	54,606	18,724	37,520	65,621	8,403	329	-	185,203
Net position	(10,284)	(3,476)	31,729	(4,583)	183	13,334	4,967	31,870
Cumulative net position up to 5 years	(10,284)	(13,760)	17,969	13,386				

23 Risk management, continued

(d) Liquidity risk, continued

The key measure used by the Bank for managing liquidity risk is the liquidity ratio stipulated by CBAR.

The Bank calculates this mandatory liquidity ratio on a daily basis in accordance with the requirement of the CBAR. This ratio is represented by the instant liquidity ratio, which is calculated as the ratio of highly liquid assets to liabilities payable on demand.

The Bank was in compliance with these ratios as at 31 December 2013 and 2012. The following table shows the mandatory liquidity ratios calculated as at 31 December 2013 and 2012.

	<u>Requirement</u>	<u>2013, %</u>	<u>2012, %</u>
Instant liquidity ratio	Not less than 30%	135.61	85.61

24 Capital management

The CBAR sets and monitors capital requirements for the Bank.

The Bank defines as capital those items defined by statutory regulation as capital for credit institutions. Under the current capital requirements set by the CBAR, banks have to hold a minimum level of capital of AZN 10,000 thousand (2012: AZN 10,000 thousand). Banks also have to maintain a ratio of total regulatory capital to risk weighted assets (statutory capital ratio) above the prescribed minimum level. As at 31 December 2013, this minimum level is 12% (31 December 2012: 12%). Further, the CBAR requires that Banks have to maintain a ratio of Tier 1 Capital to risk weighted assets at the prescribed minimum level of 6%. The Bank is in compliance with the statutory capital ratio as at 31 December 2013 and 2012.

The calculation of capital adequacy based on requirements set by the CBAR as at as at 31 December is as follows:

	<u>2013</u> <u>AZN'000</u>	<u>2012</u> <u>AZN'000</u>
Primary capital	50,489	33,824
Total capital	50,489	33,824
Risk-weighted assets	220,361	189,104
Capital adequacy ratio (%)	22.91%	17.89%

24 Capital management, continued

The Group also monitors its capital adequacy levels calculated in accordance with the requirements of the Basle Accord, as defined in the International Convergence of Capital Measurement and Capital Standards (updated April 1998) and Amendment to the Capital Accord to incorporate market risks (updated November 2007), commonly known as Basel I.

The following table shows the composition of the capital position calculated in accordance with the requirements of the Basle Accord, as at 31 December:

	2013 AZN'000	2012 AZN'000
Tier 1 capital		
Share capital	44,002	30,001
Share premium	724	-
Retained earnings	1,996	1,182
Less: Intangible assets	(88)	(96)
Total tier 1 capital	46,634	31,087
Tier 2 capital		
Reserves	2,971	2,492
Asset revaluation reserve	1,327	667
Revaluation reserve for available-for sale assets	58	20
Total tier 2 capital	4,356	3,179
Less: Investments	(1,158)	(1,110)
Total capital	49,832	33,156
Risk-weighted assets		
On-balance sheet	196,666	183,380
Off-balance sheet	41,015	15,962
Total risk weighted assets	237,681	199,342
Total capital expressed as a percentage of risk-weighted assets (total capital ratio)	20.97%	16.63%
Total tier 1 capital expressed as a percentage of risk-weighted assets (tier 1 capital ratio)	19.62%	15.59%

The risk-weighted assets are measured by means of a hierarchy of risk weights classified according to the nature and reflecting an estimate of credit, market and other risks associated with each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for unrecognised contractual commitments, with some adjustments to reflect the more contingent nature of the potential losses.

The Group is subject to minimum capital adequacy requirements calculated in accordance with the Basle Accord established by covenants under liabilities incurred by the Group. The Group has complied with all externally imposed capital requirements as at 31 December 2013 and 2012.

25 Credit related commitments

The Group has outstanding credit related commitments to extend loans. These credit related commitments take the form of approved loans and credit card limits and overdraft facilities.

The Group provides financial guarantees and letters of credit to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to five years. The Group also provides guarantees by acting as settlement agent in securities borrowing and lending transactions.

The Group applies the same credit risk management policies and procedures when granting credit commitments, financial guarantees and letters of credit as it does for granting loans to customers.

The contractual amounts of credit related commitments are set out in the following table by category. The amounts reflected in the table for credit related commitments assume that amounts are fully advanced. The amounts reflected in the table for guarantees and letters of credit represent the maximum accounting loss that would be recognised at the reporting date if counterparties failed completely to perform as contracted.

	2013 AZN'000	2012 AZN'000
Contracted amount		
Loan and credit line commitments	17,720	9,010
Guarantees and letters of credit	16,627	17,602
	34,347	26,612

The total outstanding contractual credit related commitments above do not necessarily represent future cash requirements, as these credit related commitments may expire or terminate without being funded. The majority of loan and credit line commitments do not represent an unconditional credit related commitment by the Group.

26 Operating leases

(a) Leases as lessee

The Group leases a number of premises and equipment under operating leases. The leases typically run for an initial period of five to ten years, with an option to renew the lease after that date. Lease payments are usually increased annually to reflect market rentals. None of the leases includes contingent rentals. The Bank does not have any non-cancellable leases.

27 Contingencies

(a) Insurance

The insurance industry in the Republic of Azerbaijan is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Group has some coverage for its premises and equipment, business interruption, or third party liability in respect of property or environmental damage arising from accidents on its property or relating to operations. Until the Group obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on operations and financial position.

27 Contingencies, continued

(b) Litigation

In the ordinary course of business, the Group 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.

(c) Taxation contingencies

The taxation system in the Republic of Azerbaijan continues to evolve and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by a number of authorities who have the authority to impose severe fines, penalties and interest charges. A tax year remains open for review by the tax authorities during the three subsequent calendar years; however, under certain circumstances a tax year may remain open longer. Recent events within the Azerbaijan Republic suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation.

These circumstances may create tax risks in Azerbaijan that are substantially more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Azerbaijan tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on the financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

28 Related party transactions

(a) Control relationships

The Bank does not have an ultimate controlling party.

(b) Transactions with the members of the Supervisory Board and the Management Board

Total remuneration included in personnel expenses for the years ended 31 December 2013 and 2012 is as follows:

	2013 AZN'000	2012 AZN'000
Short term employee benefits	427	379
	427	379

These amounts include cash benefits in respect of the members of the Board of Directors and the Management Board.

28 Related party transactions, continued

(b) Transactions with the members of the Supervisory Board and the Management Board, continued

The outstanding balances and average effective interest rates as at 31 December 2013 and 2012 for transactions with the members of the Board of Directors and the Management Board are as follows:

	2013 AZN'000	Average effective interest rate, %	2012 AZN'000	Average effective interest rate, %
Consolidated statement of financial position				
Loans issued (gross)	200	7.2	195	7.0
Loan impairment allowance	(1)		-	
Current accounts and deposits received	4,703	14.9	1,166	0.5
Payables for unused vacations	36	-	-	-

Amounts included in profit or loss in relation to transactions with the members of the Board of Directors and the Management Board for the year ended 31 December are as follows:

	2013 AZN'000	2012 AZN'000
Profit or loss		
Interest income	14	10
Interest expense	(147)	4
Impairment losses	(1)	-

28 Related party transactions, continued

(c) Transactions with other shareholders

In addition to its related party disclosures, the Bank disclosed outstanding balances and the related average interest rates as at 31 December 2013 and 2012 and related profit or loss amounts of transactions for the year ended 31 December 2013 and 2012 with other shareholders (holding 5% or more of shares of the Bank):

	2013		2012	
	2013 AZN'000	Average interest rate, %	2012 AZN'000	Average interest rate, %
Consolidated statement of financial position				
ASSETS				
Loans to customers				
- In AZN:				
Principal balance	885	15.0	2	12.0
Impairment allowance	20		-	
LIABILITIES				
Current accounts and deposits from customers	1,731	11.5	1,150	13.0
Profit (loss)				
Interest income	248		1	
Interest expense	(136)		(13)	
Fee and commission income	14		1	
Impairment losses	(20)		-	

The majority of balances resulting from transactions with related parties mature within one year.

29 Financial assets and liabilities: fair values and accounting classifications

(a) Accounting classifications and fair values

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at 31 December 2013:

AZN '000	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying amount	Fair value
Cash and cash equivalents	40,551	-	-	40,551	40,551
Available-for-sale financial assets	-	1,158	-	1,158	1,158
Loans to banks	12,388	-	-	12,388	12,388
Loans to customers:					
Loans to corporate customers	60,915	-	-	60,915	65,912
Loans to retail customers	116,693	-	-	116,693	109,260
Other financial assets	129	-	-	129	129
	230,683	1,158	-	231,841	229,398
Deposits and balances from banks	-	-	27,138	27,138	27,138
Current accounts and deposits from customers	-	-	108,167	108,167	109,203
Other borrowed funds	-	-	59,962	59,962	59,765
Other financial liabilities	-	-	271	271	271
	-	-	195,538	195,538	196,377

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at 31 December 2012:

AZN '000	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying amount	Fair value
Cash and cash equivalents	36,305	-	-	36,305	36,305
Available-for-sale financial assets	-	1,649	-	1,649	1,649
Loans to banks	7,215	-	-	7,215	7,215
Loans to customers:					
Loans to corporate customers	69,916	-	-	69,916	75,217
Loans to retail customers	91,363	-	-	91,363	93,679
Other financial assets	106	-	-	106	106
	204,905	1,649	-	206,554	214,171
Deposits and balances from banks	-	-	25,531	25,531	25,531
Current accounts and deposits from customers	-	-	102,760	102,760	103,978
Other borrowed funds	-	-	56,199	56,199	57,766
Other financial liabilities	-	-	158	158	158
	-	-	184,648	184,648	187,433

29 Financial assets and liabilities: fair values and accounting classifications, continued

(a) Accounting classifications and fair values, continued

The estimates of fair value are intended to approximate the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realisable in an immediate sale of the assets or transfer of liabilities.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Group determines fair values using other valuation techniques.

The objective of valuation techniques is to arrive at a fair value determination that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

The Group uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps.

For more complex instruments, the Group uses proprietary valuation models. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Example of instruments involving significant unobservable inputs include certain loans and securities for which there is no active market, certain over the counter structured derivatives, and retained interests in securitisations.

The following assumptions are used by management to estimate the fair values of financial instruments:

- discount rates of 10.76%-11.52% and 17.65%-20.74% are used for discounting future cash flows from loans to corporate customers and loans to retail customers, respectively
- discount rates of 2.98% - 5.74% and 9.81% – 10.23% are used for discounting future cash flows from current accounts and deposits of corporate and retail customers, respectively
- quoted market prices are used for determination of fair value of available for sale financial assets and financial assets at fair value through profit or loss, respectively
- in estimating the discount rates for other borrowed funds the Bank considers this market as a separate market from other commercial borrowing business due to different terms, purposes, conditions and credit risk exposures related to these other borrowed funds.

29 Financial assets and liabilities: fair values and accounting classifications, continued

(b) Fair value hierarchy

The Group measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: quoted market price (unadjusted) in an active market for an identical instrument.
- Level 2: inputs other than quotes prices included within Level 1 that are observable either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: inputs that are unobservable. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The table below analyses financial instruments measured at fair value at 31 December 2013, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the consolidated statement of financial position:

AZN '000	Level 3	Total
Available-for-sale financial assets		
- Corporate shares	1,158	1,158
	1,158	1,158

The table below analyses financial instruments measured at fair value at 31 December 2012, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the consolidated statement of financial position:

AZN '000	Level 2	Level 3	Total
Available-for-sale financial assets			
- Notes issued by Mortgage Fund of the Republic of Azerbaijan	337	-	337
- Treasury bills of the Ministry of Finance of the Republic of Azerbaijan	202	-	202
- Corporate shares	-	1,110	1,110
	539	1,110	1,649

29 Financial assets and liabilities: fair values and accounting classifications, continued

(b) Fair value hierarchy, continued

The following table analyses the fair value of financial instruments not measured at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised as at 31 December 2013:

AZN'000	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
ASSETS					
Cash and cash equivalents	-	40,551	-	40,551	40,551
Loans to banks	-	12,388	-	12,388	12,388
Loans to customers	-	-	175,172	175,172	177,608
LIABILITIES					
Deposits and balances from banks	-	27,138	-	27,138	27,138
Current accounts and deposits from customers	-	109,203	-	109,203	108,167
Other borrowed funds	-	-	59,765	59,765	59,962

The following table analyses the fair value of financial instruments not measured at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised as at 31 December 2012:

AZN'000	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
ASSETS					
Cash and cash equivalents	-	36,305	-	36,305	36,305
Loans to banks	-	7,215	-	7,215	7,215
Loans to customers	-	-	168,896	168,896	161,279
LIABILITIES					
Deposits and balances from banks	-	25,531	-	25,531	25,531
Current accounts and deposits from customers	-	103,978	-	103,978	102,760
Other borrowed funds	-	-	57,766	57,766	56,199

Mr. Nazim Sadigov
Chairman of the Management Board



Mr. Alizaman Ibrahimov
Head of Financial Management Department