

**TURANBANK OPEN
JOINT- STOCK COMPANY**

**Consolidated Financial Statements
for the year ended 31 December 2011**

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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 2011, and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, 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 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 of 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 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other Matter

The consolidated financial statements of the Group as at and for the year ended 31 December 2010 were audited by other auditors whose report dated 16 May 2011 expressed an unmodified opinion on those statements.

KPMG Azerbaijan Limited

29 March 2012

Turanbank OJSC
Consolidated Statement of Comprehensive Income for the year ended 31 December 2011

	Notes	2011 AZN'000	2010 AZN'000
Interest income	4	15,908	13,327
Interest expense	4	(8,037)	(6,600)
Net interest income		7,871	6,727
Fee and commission income	5	2,181	1,720
Fee and commission expense	6	(349)	(237)
Net fee and commission income		1,832	1,483
Gains less losses from trading in foreign currencies		514	336
Net foreign exchange income		68	13
Other operating income	7	69	121
Operating income		10,354	8,680
Impairment losses	14	(1,037)	(2,903)
Personnel expenses	8	(3,135)	(2,422)
Other general administrative expenses	9	(2,337)	(2,042)
Profit before income tax		3,845	1,313
Income tax expense	10	(689)	(28)
Profit for the year		3,156	1,285
Other comprehensive income, net of income tax			
Revaluation of buildings		-	(358)
Other comprehensive income for the year, net of income tax		-	(358)
Total comprehensive income for the year		3,156	927
Earnings per share for profit attributable to the equity holders of the Bank during the year (expressed in AZN per share):			
- Basic/Diluted	22	147	71

The consolidated financial statements as set out on pages 4 to 59 were approved by management on 29 March 2012 and were signed on its behalf by:


 Mr. Nazim Sadigov
 Chairman of the Management Board




 Mr. Alizaman Ibrahimov
 Chief Accountant

The consolidated statement of 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 2011

	Notes	2011 AZN'000	2010 AZN'000
ASSETS			
Cash and cash equivalents	11	27,527	14,111
Available-for-sale financial assets			
- Held by the Group	12	7,377	1,542
- Pledged under sale and repurchase agreements	12	1,000	-
Loans and advances to banks	13	3,917	532
Loans to customers	14	116,997	100,402
Property, equipment and intangible assets	15	8,241	7,954
Deferred tax asset	10	25	376
Other assets	16	680	319
Total assets		165,764	125,236
LIABILITIES			
Deposits and balances from banks	17	7,298	8,118
Current accounts and deposits from customers	18	86,727	54,512
Other borrowed funds	19	47,414	40,382
Current tax liability		194	78
Other liabilities	20	243	322
Total liabilities		141,876	103,412
EQUITY			
Share capital	21	22,000	20,000
Revaluation surplus for buildings		710	710
Retained earnings		1,178	1,114
Total equity		23,888	21,824
Total liabilities and equity		165,764	125,236

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 2011

	Notes	2011 AZN'000	2010 AZN'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest receipts		14,748	12,582
Interest payments		(7,149)	(6,072)
Fee and commission receipts	5	2,181	1,720
Fee and commission payments	6	(349)	(237)
Income received from trading in foreign currencies		514	336
Other income receipts		29	121
General administrative payments		(4,882)	(3,838)
(Increase) decrease in operating assets			
Loans and advances to banks		(3,379)	218
Loans to customers		(16,486)	(25,847)
Other assets		(348)	(216)
Increase (decrease) in operating liabilities			
Deposits and balances from banks		(915)	539
Current accounts and deposits from customers		31,500	8,958
Other liabilities		(79)	33
Net cash provided from/(used in) operating activities before income tax paid		15,385	(11,703)
Income tax paid		(222)	(308)
Cash flows from/(used in) operations		15,163	(12,011)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of property and equipment and intangible assets	15	(904)	(960)
Sales of property and equipment and intangible assets		-	4
Purchases of available-for-sale financial assets		(7,439)	(1,427)
Sale and repayment of available-for-sale financial assets		621	3,269
Dividends received	7	40	65
Cash flows (used in)/from investing activities		(7,682)	951
CASH FLOWS FROM FINANCING ACTIVITIES			
Receipts of borrowed funds		14,937	8,714
Repayment of borrowed funds		(7,949)	(873)
Proceeds from issuance of share capital		300	1,700
Dividends paid		(1,392)	(1,714)
Cash flows from financing activities		5,896	7,827
Net increase (decrease) in cash and cash equivalents		13,377	(3,233)
Effect of changes in exchange rates on cash and cash equivalents		39	(20)
Cash and cash equivalents as at the beginning of the period		14,111	17,364
Cash and cash equivalents as at the end of the period	11	27,527	14,111

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

	Attributable to equity holders of the Bank			
	Share capital	Revaluation surplus for buildings	Retained earnings	Total
Balance as at 1 January 2010	17,000	1,068	2,843	20,911
Total comprehensive income				
Profit for the year	-	-	1,285	1,285
Other comprehensive income				
Revaluation of property and equipment, net of income tax	-	(358)	-	(358)
Total comprehensive income for the year	-	(358)	1,285	927
Transactions with owners, recorded directly in equity				
Shares issued (Note 21)	1,700	-	-	1,700
Transfer of profit and issue of share capital (Note 21)	1,300	-	(1,300)	-
Dividends declared (Note 21)	-	-	(1,714)	(1,714)
Total transactions with owners	3,000	-	(3,014)	(14)
Balance as at 31 December 2010	20,000	710	1,114	21,824
Balance as at 1 January 2011	20,000	710	1,114	21,824
Total comprehensive income				
Profit for the year	-	-	3,156	3,156
Total comprehensive income for the year	-	-	3,156	3,156
Transactions with owners, recorded directly in equity				
Shares issued (Note 21)	300	-	-	300
Transfer of profit and issue of share capital (Note 21)	1,700	-	(1,700)	-
Dividends declared (Note 21)	-	-	(1,392)	(1,392)
Total transactions with owners	2,000	-	(3,092)	(1,092)
Balance as at 31 December 2011	22,000	710	1,178	23,888

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.

1 Background

(a) Organisation 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 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 accounts maintenance, lending, issuing guarantees, cash and settlement operations and operations with securities and foreign exchange. 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 scheme which was introduced by the Azeri Law, *Deposits of individuals insurance in the Republic of Azerbaijan*, dated 29 December 2006. The State Deposit Insurance Fund guarantees repayment of 100% of deposits by individuals depending on when the deposit was placed with the Bank:

- until 1 January 2008 – up to AZN 4,000;
- from 1 January 2008 until 1 January 2010 – up to AZN 6,000;
- 1 January 2010 and afterwards – up to AZN 30,000.

The Bank’s registered address is:

Ismayil bey Gutgashinly 85 Street
AZ1073
Baku, Republic of Azerbaijan

The Bank has thirteen (2010: twelve) branches within the Republic 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.

(b) Shareholders

As at 31 December 2011 the Bank has 26 shareholders each having less than 10% ownership. Mr. Nazim Sadigov was disclosed as the ultimate controlling party in the consolidated financial statements of the Group for the year ended 31 December 2010. Management have revised this disclosure and now believes that both for the year ended 31 December 2011 and 31 December 2010 the Bank has no ultimate controlling party who has the power to direct the transactions of the Group at his/her own discretion and for his/her own benefit.

1 Background (Continued)

(b) Shareholders (Continued)

Shareholding structure of Turanbank OJSC as at 31 December 2011.

Shareholders	% of Shareholding
Fuzuli Guluyev	9.20
Fuad Musayev	9.00
"Turac-AF" LLC	8.21
Davud Guliyev	7.00
Vugar Askarov	6.92
"Fidan" Company	6.91
Yashar Safarov	6.91
Vugar Mammadov	5.77
Akif Nabiyev	5.00
Other shareholders (less than 5% each)	35.08
Total	100.00

(c) 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.

2 Basis of preparation (Continued)

(c) Functional and presentation currency

The functional currency of the Bank 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, unless otherwise stated.

(d) Use of estimates and judgements

The preparation of consolidated financial statements in conformity with IFRSs 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 critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements is included in the following notes:

- loan impairment estimates - Note 14
- building revaluation estimates - Note 15
- tax contingency estimates - Note 28
- estimates of fair values of financial instruments – Note 30

(e) Changes in accounting policies and presentation

With effect from 1 January 2011, the Group changed its accounting policies in the following areas:

- With effect from 1 January 2011, the Group retrospectively applied a revised version of IAS 24 (issued in 2009) Related Party Disclosures. This change has not had a significant impact on the related party disclosures;
- With effect from 1 January 2011, the Group retrospectively applied limited amendments to IFRS 7 Financial Instruments: Disclosures issued as part of Improvements to IFRSs 2010. These amendments mainly relate to disclosures on collateral and other credit enhancements, as well as to renegotiated assets that would otherwise be past due or impaired.

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.

(a) Basis of consolidation

(i) *Subsidiaries*

Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively 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. 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 or qualifying cash flow hedges, 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.

3 Significant accounting policies (Continued)

(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 financial instruments that are 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.

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 loan and receivables may be reclassified out of the fair value through profit or loss or available-for-sale category if the entity has an intention and ability to hold it 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:

3 Significant accounting policies (Continued)

(d) Financial instruments (Continued)

(i) Classification (Continued)

- 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 recognised 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 amortised cost using the effective interest method
- held-to-maturity investments that are measured at amortised 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 can not 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 amortised 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 amortised based on the effective interest rate of the instrument.

3 Significant accounting policies (Continued)

(d) Financial instruments (Continued)

(v) *Fair value measurement principles*

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms' length transaction on the measurement date.

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 quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, the Group establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e., the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model is subsequently recognised in profit or loss on an appropriate basis over the life of the instrument but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

Assets and long positions are measured at a bid price; liabilities and short positions are measured at an asking price. Where the Group has positions with offsetting risks, mid-market prices are used to measure the offsetting risk positions and a bid or asking price adjustment is applied only to the net open position as appropriate. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group entity and the counterparty where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties; to the extent that the Group believes a third-party market participant would take them into account in pricing a transaction.

(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 recognised as follows:

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

3 Significant accounting policies (Continued)

(d) Financial instruments (Continued)

(vi) *Gains and losses on subsequent measurement (Continued)*

- a gain or loss on an available-for-sale financial asset is recognised 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 derecognised, at which time the cumulative gain or loss previously recognised in equity is recognised in profit or loss. Interest in relation to an available-for-sale financial asset is recognised in profit or loss using the effective interest method.

For financial assets and liabilities carried at amortised cost, a gain or loss is recognised in profit or loss when the financial asset or liability is derecognised or impaired, and through the amortisation 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 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) *Repurchase and reverse repurchase agreements*

Securities sold under sale and repurchase (repo) agreements are accounted for as secured financing transactions, with the securities retained in the consolidated statement of financial position and the counterparty liability included in amounts payable under repo transactions within deposits and balances from banks or current accounts and deposits from customers, as appropriate. The difference between the sale and repurchase prices represents interest expense and is recognised in profit or loss over the term of the repo agreement using the effective interest method.

3 Significant accounting policies (Continued)

(d) Financial instruments (Continued)

(viii) *Repurchase and reverse repurchase agreements (Continued)*

Securities purchased under agreements to resell (reverse repo) are recorded as amounts receivable under reverse repo transactions within loans and advances to banks or loans to customers, as appropriate. The difference between the purchase and resale prices represents interest income and is recognised in profit or loss over the term of the repo agreement using the effective interest method.

If assets purchased under an agreement to resell are sold to third parties, the obligation to return securities is recorded as a trading liability and measured at fair value.

(ix) *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.

(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) *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.

(iii) *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
- Computers and communication equipment	4 years
- Furniture, fixture and other equipment	5 years
- Motor vehicles	5 years
- Leasehold improvement	Over the term of the underlying lease

3 Significant accounting policies (Continued)

(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.

(g) Impairment

(i) *Financial assets carried at amortised cost*

Financial assets carried at amortised 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. A loan or receivable 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 loan or receivable and that event (or events) has had an impact on the estimated future cash flows of the loan 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 a loan or advance on terms 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.

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 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, when appropriate, 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.

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 judgement to estimate the amount of any impairment loss.

3 Significant accounting policies (Continued)

(g) Impairment (Continued)

(i) *Financial assets carried at amortised cost (Continued)*

All impairment losses in respect of loans and receivables are recognised 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 can not 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 recognised in profit or loss and can not 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.

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.

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)

(g) 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 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 recognised 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.

(h) 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.

(i) 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)

(i) 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
- 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.

(j) 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) Dividends

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

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

(k) 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 is 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 is 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. Deferred tax is 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.

A deferred tax asset is 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 it is no longer probable that the related tax benefit will be realised.

3 Significant accounting policies (Continued)

(l) 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 amortised 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.

(m) 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.

(n) Comparative information

Comparative information is reclassified to conform to changes in presentation in the current year.

(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 2011, 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. The Group has not yet analysed the likely impact of the following new standards on its financial position or performance.

3 Significant accounting policies (Continued)

(o) New standards and interpretations not yet adopted (Continued)

- IFRS 9 Financial Instruments will be effective for annual periods beginning on or after 1 January 2015. 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 Group recognises that the new standard introduces many changes to the accounting for financial instruments and is likely to have a significant impact on Group's 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.
- IFRS 13 *Fair Value Measurement* will be effective for annual periods beginning on or after 1 January 2013. The new standard replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It provides a revised definition of fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. IFRS 13 does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurement that currently exist in certain standards. The standard is applied prospectively with early adoption permitted. Comparative disclosure information is not required for periods before the date of initial application.
- Amendment to IAS 1 *Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income*. The amendment requires that an entity present separately items of other comprehensive income that may be reclassified to profit or loss in the future from those that will never be reclassified to profit or loss. Additionally, the amendment changes the title of the statement of comprehensive income to statement of profit or loss and other comprehensive income. However, the use of other titles is permitted. The amendment shall be applied retrospectively from 1 July 2012 and early adoption is permitted.

4 Net interest income

	2011 AZN'000	2010 AZN'000
Interest income		
Loans to customers	15,445	12,884
Loans and advances to banks	397	348
Available-for-sale financial assets	66	95
	15,908	13,327
Interest expense		
Current accounts and deposits from customers	6,519	5,505
Other borrowed funds	1,185	957
Deposits and balances from banks	333	138
	8,037	6,600

Included within various line items under interest income for the year ended 31 December 2011 is a total amount of AZN 1,102 thousand (2010: AZN 896 thousand) accrued interest on impaired financial assets.

5 Fee and commission income

	2011 AZN'000	2010 AZN'000
Cash withdrawal	995	954
Annual credit card maintenance	385	250
Guarantee and letter of credit issuance	297	174
Servicing customers accounts	275	208
Transactions with foreign exchange	225	123
Settlement	2	2
Other	2	9
	2,181	1,720

6 Fee and commission expense

	2011 AZN'000	2010 AZN'000
Annual credit card maintenance	167	96
Servicing customers accounts	80	53
Guarantee and letter of credit issuance	69	55
Cash withdrawal	25	32
Other	8	1
	349	237

7 Other operating income

	2011 AZN'000	2010 AZN'000
Dividend income	40	65
Rent income	16	46
Other income	13	10
	69	121

8 Personnel expenses

	2011 AZN'000	2010 AZN'000
Employee compensation	2,575	1,973
Social security payment	560	449
	3,135	2,422

9 Other general administrative expenses

	2011 AZN'000	2010 AZN'000
Depreciation and amortisation (Note 15)	590	534
Advertising and marketing	382	218
Security	236	202
Communications and information services	214	185
Professional services	210	214
Other	160	204
Operating lease expense	152	132
Repairs and maintenance	130	111
Taxes other than on income	76	55
Office supplies	72	90
Travel expenses	55	51
Utilities	44	34
Insurance	16	12
	2,337	2,042

10 Income tax expense

	2011 AZN'000	2010 AZN'000
Current year tax expense	338	308
Deferred taxation movement due to origination and reversal of temporary differences and movement in valuation allowance	351	(280)
Total income tax expense	689	28

10 Income tax expense (Continued)

During 2011, the applicable tax rate for current and deferred tax was 20% (2010: 20%).

Reconciliation of effective tax rate:

	2011 AZN'000	%	2010 AZN'000	%
Profit before tax	<u>3,845</u>		<u>1,313</u>	
Income tax at applicable tax rate	769	20%	262	20%
Transfer to share capital	(361)	(9%)	(331)	(25%)
Correction of prior year error	267	7%	-	-%
Non-deductible costs	22	1%	97	7%
Non-taxable income	(8)	-%	-	-%
	<u>689</u>	<u>19%</u>	<u>28</u>	<u>2%</u>

On 14 November 2008, a new law on “Stimulation of increasing the capitalisation of banks, insurance and reinsurance companies” was enacted in the Republic of Azerbaijan. According to the Law the profit tax rate for banks, insurance and reinsurance companies will be applicable at 0% for three fiscal years effective from 1 January 2009, for the portion of profits transferred to share capital. At 31 December 2011, the management of the Group planned to take advantage of this concession and to transfer AZN 1,804 thousand of the profit for the year ended 31 December 2011 to share capital (2010: AZN 1,700 thousand of the profit for the year ended 31 December 2010). On 27 February 2012 the Group made this transfer. All assessments of the current taxes of the Group were made on the basis of the tax concession. (Note 31)

(a) Deferred tax asset and liability

Differences between IFRS and the Azerbaijani statutory taxation rules give rise to certain temporary differences between the carrying value of certain assets and liabilities for purposes of both financial reporting and income tax calculation purposes. The tax effect of the movements in these temporary differences is recorded at the rate of 20%.

Movements in temporary differences during the years ended 31 December 2011 and 2010 are presented as follows.

2011 AZN'000	Balance 1 January 2011	Recognised in profit or loss	Balance 31 December 2011
Available-for-sale financial assets	(3)	3	-
Loans to customers	513	(29)	484
Property and equipment and intangible assets	(134)	(27)	(161)
Property and equipment and intangible assets (correction of prior year error)	-	(267)	(267)
Other assets	-	(14)	(14)
Other liabilities	-	(17)	(17)
	<u>376</u>	<u>(351)</u>	<u>25</u>

10 Income tax expense (Continued)

(a) Deferred tax asset and liability (Continued)

2010 AZN'000	Balance 1 January 2010	Recognised in profit or loss	Recognised in other comprehens ive income	Balance 31 December 2010
Available-for-sale financial assets	(1)	(2)	-	(3)
Loans to customers	121	392	-	513
Property and equipment and intangible assets	(113)	(110)	89	(134)
	<u>7</u>	<u>280</u>	<u>89</u>	<u>376</u>

11 Cash and cash equivalents

	2011 AZN'000	2010 AZN'000
Cash on hand	8,292	4,388
Nostro accounts with the CBAR	6,130	4,216
Nostro accounts with other banks		
- rated A- to A+	6,161	1,786
- rated BBB	12	3
- rated from BB- to BB+	154	45
- rated below B+	1,588	460
- not rated	3,674	1,366
Total nostro accounts with other banks	11,589	3,660
Cash equivalents		
- Term deposits with other banks		
- rated A- to A+	-	901
- rated BBB	-	2
- rated from BB- to BB+	529	23
- rated below B+	-	232
- not rated	987	689
Total term deposits with other banks	1,516	1,847
Total cash equivalents	1,516	1,847
Total cash and cash equivalents	27,527	14,111

None of cash and cash equivalents are impaired or past due.

As at 31 December 2011 the Group has two banks (2010: one bank), whose balances exceed 10% of equity. The gross value of these balances as at 31 December 2011 is AZN 10,246 thousand (2010: AZN 4,216 thousand).

12 Available-for-sale financial assets

	2011 AZN'000	2010 AZN'000
Held by the Group		
Debt and other fixed-income instruments		
- Government and municipal bonds		
Notes issued by CBAR	4,000	-
Notes issued by Mortgage Fund of the Republic of Azerbaijan	2,050	-
Treasury bills of the Ministry of Finance of the Republic of Azerbaijan	242	632
Total government and municipal bonds	6,292	632
Equity investments		
- Corporate shares (at cost)	1,085	910
	7,377	1,542
Pledged under sale and repurchase agreements		
Notes issued by CBAR		
rated from BB- to BB+	1,000	-
	8,377	1,542

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, investments with a carrying amount of AZN 175 thousand were acquired during the current year and management believes it unlikely that the fair value at the year end would differ significantly from that carrying amount.

13 Loans and advances to banks

	2011 AZN'000	2010 AZN'000
Mandatory reserve with CBAR	1,641	184
Loans and deposits		
Largest 5 Azerbaijani banks	8	9
Other Azerbaijani banks	2,266	339
Other foreign banks	2	-
	3,917	532

(a) Collateral accepted as security for assets

There are no overdue or impaired loans and advances to banks as at 31 December 2011 and the fair value of financial assets received by the Group as collateral is AZN 1,752 thousand (2010: AZN 528 thousand), excluding the effect of over collateralisation.

(b) Concentration of loans and advances to banks

As at 31 December 2011 the Group has no banks (2010: none), whose balances exceed 10% of equity.

(c) Mandatory reserve with 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.

14 Loans to customers

	2011	2010
	<u>AZN'000</u>	<u>AZN'000</u>
Loans to corporate customers		
Loans to large corporates	22,416	10,639
Loans to small and medium size companies	36,724	43,785
Total loans to corporate customers	<u>59,140</u>	<u>54,424</u>
Loans to retail customers		
Consumer	28,152	14,371
Entrepreneur	21,563	28,865
Mortgage	9,621	7,662
Other	5,474	996
Total loans to retail customers	<u>64,810</u>	<u>51,894</u>
Gross loans to customers	<u>123,950</u>	<u>106,318</u>
Impairment allowance	(6,953)	(5,916)
Net loans to customers	<u>116,997</u>	<u>100,402</u>

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2011 are as follows:

	Loans to corporate customers	Loans to retail customers	Total
	<u>AZN'000</u>	<u>AZN'000</u>	<u>AZN'000</u>
Balance at the beginning of the year	3,641	2,275	5,916
Net charge	952	85	1,037
Balance at the end of the year	<u>4,593</u>	<u>2,360</u>	<u>6,953</u>

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2010 are as follows:

	Loans to corporate customers	Loans to retail customers	Total
	<u>AZN'000</u>	<u>AZN'000</u>	<u>AZN'000</u>
Balance at the beginning of the year	1,316	1,697	3,013
Net charge (recovery)	2,325	578	2,903
Balance at the end of the year	<u>3,641</u>	<u>2,275</u>	<u>5,916</u>

14 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 2011:

	Gross loans AZN'000	Impairmen t 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	22,412	537	21,875	2%
Impaired loans:				
-overdue less than 90 days	4	-	4	-
Total impaired loans	4	-	4	-
Total loans to large corporates	22,416	537	21,879	2%
Loans to small and medium size companies				
Loans without individual signs of impairment	29,398	688	28,710	2%
Impaired loans:				
- overdue less than 90 days	5,344	2,255	3,089	42%
- overdue more than 1 year	1,982	1,113	869	56%
Total impaired loans	7,326	3,368	3,958	46%
Total loans to small and medium size companies	36,724	4,056	32,668	11%
Total loans to corporate customers	59,140	4,593	54,547	8%
Loans to retail customers				
Loans to individuals- consumer loans				
Loans without individual signs of impairment	26,749	709	26,040	3%
Impaired loans:				
- overdue less than 90 days	1,023	262	761	26%
- overdue more than 1 year	380	60	320	16%
Total impaired loans	1,403	322	1,081	23%
Total consumer loans	28,152	1,031	27,121	4%
Loans to individuals- entrepreneur loans				
Loans without individual signs of impairment	20,288	449	19,839	2%
Impaired loans:				
- overdue less than 90 days	849	276	573	33%
- overdue more than 90 days and less than 1 year	39	5	34	13%
- overdue more than 1 year	387	140	247	36%
Total impaired loans	1,275	421	854	33%
Total entrepreneur loans	21,563	870	20,693	4%

14 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, %
Mortgage loans				
Loans without individual signs of impairment	9,600	226	9,374	2%
Impaired loans:				
- overdue less than 90 days	21	3	18	14%
Total mortgage loans	9,621	229	9,392	2%
Other loans to retail customers				
Loans without individual signs of impairment	4,595	109	4,486	2%
Impaired loans:				
- overdue less than 90 days	355	48	305	14%
- overdue more than 90 days and less than 1 year	6	1	5	17%
- overdue more than 1 year	518	72	448	14%
Total impaired loans	879	121	758	14%
Total other loans to retail customers	5,474	230	5,244	4%
Total loans to retail customers	64,810	2,360	62,450	4%
Total loans to customers	123,950	6,953	116,997	6%

The following table provides information on the credit quality of the loans to customers as at 31 December 2010:

	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	10,639	295	10,344	3%
Total loans to large corporates	10,639	295	10,344	3%
Loans to small and medium size companies				
Loans without individual signs of impairment	34,369	693	33,676	2%
Impaired loans:				
- overdue less than 90 days	3,079	318	2,761	10%
- overdue more than 90 days and less than 1 year	2,628	366	2,262	14%
- overdue more than 1 year	3,709	1,969	1,740	53%
Total impaired loans	9,416	2,653	6,763	28%
Total loans to small and medium size companies	43,785	3,346	40,439	8%
Total loans to corporate customers	54,424	3,641	50,783	7%

14 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	%
Loans to retail customers				
Loans to individuals- consumer loans				
Loans without individual signs of impairment	12,785	206	12,579	2%
Impaired loans:				
- overdue less than 90 days	437	39	398	9%
- overdue more than 90 days and less than 1 year	810	412	398	51%
- overdue more than 1 year	339	230	109	68%
Total impaired loans	1,586	681	905	43%
Total consumer loans	14,371	887	13,484	6%
Loans to individuals- entrepreneur loans				
Loans without individual signs of impairment	26,528	496	26,032	2%
Impaired loans:				
- overdue less than 90 days	404	28	376	7%
- overdue more than 90 days and less than 1 year	1,460	248	1,212	17%
- overdue more than 1 year	473	92	381	19%
Total impaired loans	2,337	368	1,969	16%
Total entrepreneur loans	28,865	864	28,001	3%
Mortgage loans				
Loans without individual signs of impairment	7,564	379	7,185	5%
Impaired loans:				
- overdue less than 90 days	76	22	54	29%
- overdue more than 1 year	22	22	-	100%
Total impaired loans	98	44	54	45%
Total mortgage loans	7,662	423	7,239	6%
Other loans to retail customers				
Loans without individual signs of impairment	840	19	821	2%
Impaired loans:				
- overdue more than 1 year	156	82	74	53%
Total other loans to retail customers	996	101	895	10%
Total loans to retail customers	51,894	2,275	49,619	4%
Total loans to customers	106,318	5,916	100,402	6%

As at 31 December 2011 included in the loan portfolio are renegotiated loans to customers that would otherwise be past due or impaired of AZN 309 thousand (2010: AZN 271 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.

14 Loans to customers (Continued)

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

Impairment of loans to customers

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 portfolios, 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 impaired loans 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. 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, 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 20% and 50% to the originally appraised value if the property pledged is sold;
- a delay of 12 to 24 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 2011 would be AZN 1,170 thousand lower/higher (2010: AZN 1,004 thousand lower/higher).

14 Loans to customers (Continued)

(c) Analysis of collateral

The following table provides an analysis of loans to customers, net of impairment, by types of collateral as at 31 December 2011 and 2010:

	2011 AZN'000	% of loan portfolio	2010 AZN'000	% of loan portfolio
Real estate	79,812	68%	60,831	60%
Letter of guarantee	7,934	7%	15,701	16%
Jewellery	4,604	4%	2,750	3%
Vehicles	4,276	4%	5,904	6%
Equipment	4,062	3%	5	0%
Cash deposits	3,240	3%	5,259	5%
Tradable securities	2,709	2%	23	0%
Other assets	3,849	3%	2,574	3%
No collateral	6,511	6%	7,355	7%
	116,997	100%	100,402	100%

The amounts shown in the table above represent the carrying value of the loans, and do not necessarily represent the fair value of the collateral.

Loans to customers that are past due or impaired

Impaired or overdue loans to customers with a gross value of AZN 8,262 thousand (2010: AZN 7,421 thousand) are secured by collateral with a fair value of AZN 6,085 thousand (2010: AZN 4,413 thousand), excluding the effect of overcollateralisation. For the remaining impaired loans of AZN 2,646 thousand (2010: AZN 6,172 thousand), there is no collateral or it is impracticable to determine the fair value of collateral.

Loans to customers that are neither past due nor impaired

As at 31 December 2011 the fair value of traded securities and cash balances, serving as collateral for loans to customers, is AZN 5,949 thousand (2010: AZN 5,282 thousand), excluding the effect of overcollateralisation..

For remaining loans to customers with a net carrying amount of AZN 104,375 thousand (2010: AZN 85,355 thousand), which are neither past due nor impaired, the fair value of collateral was estimated at the inception of the loans and was not adjusted for subsequent changes to the reporting date. The recoverability of these loans is primarily dependent on the creditworthiness of the borrowers rather than the value of collateral, and the current value of the collateral does not impact the impairment assessment.

During the year ended 31 December 2011 the Group obtained assets with the carrying amount of AZN 236 thousand by taking control of collateral securing loans to corporate customers (2010: nil).

14 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 which operate in the following economic sectors:

	2011	2010
	AZN'000	AZN'000
Consumer loans	28,152	14,371
Production	26,412	22,593
Agriculture	23,287	25,578
Trade and services	21,288	22,933
Purchase of apartments and mortgages	9,621	7,662
Construction	9,347	10,966
Other	5,843	2,215
	123,950	106,318
Impairment allowance	(6,953)	(5,916)
	116,997	100,402

(e) Significant credit exposures

As at 31 December 2011 the Group has seven borrowers (2010: five), whose loan balances exceed 10% of the Group's equity. The gross value of these loans as at 31 December 2011 is AZN 24,915 thousand (2010: AZN 15,528 thousand).

(f) Loan maturities

The maturity of the loan portfolio is presented in note 24(d), which shows the remaining period from the reporting date to the contractual maturity of the loans. Due to the short-term nature of the loans issued by the Group, it is likely that many of the loans will be prolonged at maturity. Accordingly, the effective maturity of the loan portfolio may be significantly longer than the term based on contractual terms.

15 Property, equipment and intangible assets

	<u>Buildings</u>	<u>Leasehold improvement</u>	<u>Equipment</u>	<u>Fixtures and fittings</u>	<u>Other fixed assets</u>	<u>Computer software</u>	<u>Total</u>
Cost/revalued amount							
Balance at 1 January 2011	6,782	325	529	1,068	263	170	9,137
Additions	60	300	95	264	177	8	904
Disposals	-	-	(24)	(23)	(67)	-	(114)
Balance at 31 December 2011	6,842	625	600	1,309	373	178	9,927
Depreciation, amortisation and impairment losses							
Balance at 1 January 2011	-	(39)	(337)	(566)	(148)	(93)	(1,183)
Depreciation and amortisation for the year	(206)	(27)	(109)	(204)	(27)	(17)	(590)
Disposals	-	-	24	23	40	-	87
Balance at 31 December 2011	(206)	(66)	(422)	(747)	(135)	(110)	(1,686)
Carrying amount							
At 31 December 2011	6,636	559	178	562	238	68	8,241
At 1 January 2011	6,782	286	192	502	115	77	7,954

15 Property, equipment and intangible assets (Continued)

	<u>Buildings</u>	<u>Leasehold improvement</u>	<u>Equipment</u>	<u>Fixtures and fittings</u>	<u>Other fixed assets</u>	<u>Computer software</u>	<u>Total</u>
Cost/revalued amount							
Balance at 1 January 2010	6,859	207	436	824	209	149	8,684
Transfers from investment property	358	-	-	-	-	-	358
Additions	426	120	94	244	55	21	960
Disposals	-	(2)	(1)	-	(1)	-	(4)
Transfer of accumulated depreciation on revaluation	(414)	-	-	-	-	-	(414)
Revaluation loss	(447)	-	-	-	-	-	(447)
At 31 December 2010	6,782	325	529	1,068	263	170	9,137
Depreciation, amortisation and impairment losses							
Balance at 1 January 2010	(203)	(23)	(242)	(408)	(106)	(77)	(1,059)
Depreciation and amortization for the year	(211)	(14)	(94)	(158)	(41)	(16)	(534)
Revaluation	414	-	-	-	-	-	414
Disposals	-	(2)	(1)	-	(1)	-	(4)
Balance at 31 December 2010	-	(39)	(337)	(566)	(148)	(93)	(1,183)
Carrying amounts							
At 31 December 2010	6,782	286	192	502	115	77	7,954
At 1 January 2010	6,656	184	194	416	103	72	7,625

There are no capitalised borrowing costs related to the acquisition or construction of plant and equipment during 2011 (2010: nil).

(a) Revalued assets

There was no revaluation during 2011. At 31 December 2010, the buildings were revalued based on the results of an independent appraisal performed by REC-Invest. 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 carrying value of buildings as at 31 December 2011, if the buildings would not have been revalued, would be AZN 5,775 thousand (2010: AZN 5,895 thousand).

16 Other assets

	2011	2010
	AZN'000	AZN'000
Prepayments and other debtors	285	41
Repossessed collateral	237	-
Tax settlements, other than income tax	80	-
Credit and debit cards receivables	35	19
Sundry receivables	9	255
Other	34	4
Total other assets	680	319

17 Deposits and balances from banks

	2011	2010
	AZN'000	AZN'000
Vostro accounts	36	-
Term deposits	7,262	8,118
	7,298	8,118

As at 31 December 2011 the Group has one bank (2010: one bank), whose balances exceed 10% of the equity. The gross value of the balance as at 31 December 2011 was AZN 5,500 thousand (2010: AZN 5,500 thousand).

18 Current accounts and deposits from customers

	2011	2010
	AZN'000	AZN'000
Current accounts and demand deposits		
- Retail	9,415	4,157
- Corporate	24,186	9,979
Term deposits		
- Retail	41,813	33,120
- Corporate	11,313	7,256
	86,727	54,512

As at 31 December 2011, the Group maintained customer deposit balances of AZN 10,183 thousand (2010: AZN 9,364 thousand) that serve as collateral for loans and unrecognised credit instruments granted by the Group.

As at 31 December 2011, the Group has three customers (2010: one customer), whose balances exceed 10% of the Group's equity. These balances as at 31 December 2011 are AZN 22,688 thousand (2010: AZN 4,797 thousand).

19 Other borrowed funds

	2011	2010
	AZN'000	AZN'000
Funds borrowed from the National Fund for Support of Entrepreneurship of the Republic of Azerbaijan	20,230	19,296
Funds borrowed from the State Agency for Agricultural Credits	6,616	7,022
Funds borrowed from International Finance Corporation (IFC)	5,513	-
Funds borrowed from Azerbaijan Mortgage Fund	7,427	5,794
Funds borrowed from World Business Capital Inc (WBC)	4,319	4,993
Funds borrowed from Islamic Cooperation for Development of the Private Sector (ICDPS)	1,278	643
Funds borrowed from International Fund for Agricultural development (IFAD)	2,010	2,634
Other	21	-
	47,414	40,382

In September 2002, the Group signed an agreement with the National Fund for Support of Entrepreneurship 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 of 31 December 2011 the Group has AZN 20,230 thousand (31 December 2010: AZN 19,296 thousand) payable to the fund, repayable on 25 September 2014. 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 of 31 December 2011 the Group has AZN 6,616 thousand (31 December 2010: AZN 7,022 thousand) payable to the Agency that is repayable from 2012 to 2014. The borrowing agreement does not include any financial covenants.

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 2011, the outstanding amount of debt under this credit agreement was AZN 5,513 thousand (31 December 2010: nil) 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. As at 31 December 2011, the Group was not in compliance with the single currency foreign exchange risk ratio, and the aggregate foreign exchange risk ratio specified in this loan agreement, therefore the outstanding amount is contractually repayable on demand. The Group does not expect IFC to exercise its right to immediate repayment.

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 of 31 December 2011 the Group has AZN 7,427 thousand (31 December 2010: AZN 5,794 thousand) payable to the Fund. There are no financial covenants with regard to borrowings from Azerbaijan Mortgage Fund that the Group should comply with.

19 Other borrowed funds (Continued)

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 2011, the Group had drawn down credit in the amount of AZN 4,319 thousand (31 December 2010: AZN 4,993 thousand) at an interest rate of 4.125% (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. As at 31 December 2011, the Group was in compliance with the financial covenants, but cross default on other borrowings can bring default on the borrowing as specified in this loan agreement. The outstanding amount is contractually repayable on demand. The Group does not expect WBC to exercise its right to immediate repayment.

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 2011, the outstanding amount under both credit agreements was AZN 1,278 thousand (31 December 2010: AZN 643 thousand) that is repayable from 2013 to 2015. 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. As at 31 December 2011, the Group was not in compliance with the foreign currency open position to total tier 1 capital ratio and the exposure of any single party to tier 1 capital ratio specified in this loan agreement, therefore the outstanding amount is contractually repayable on demand. The Group does not expect ICDPS to exercise its right to immediate repayment.

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 2011, the Group had total borrowings of AZN 553 thousand and USD 1,853 thousand (31 December 2010: AZN 786 thousand and USD 2,316 thousand) from IFAD that is repayable from 2012 to 2014. Interest is charged on IFAD borrowings from 2-7% depending on the specific project for which the loan is made. The borrowing agreement does not include any financial covenants.

20 Other liabilities

	2011	2010
	AZN'000	AZN'000
Amounts in course of settlement	101	138
Payables on settlement of securities	5	-
Other financial liabilities	19	91
Total other financial liabilities	125	229
Provision for guarantees and letters of credit issued	105	93
Other non-financial liabilities	13	-
Total other non-financial liabilities	118	93
Total other liabilities	243	322

21 Share Capital

(a) Issued capital and share premium

The authorised, issued and outstanding share capital comprises 22,000 ordinary shares (2010: 20,000). All shares have a nominal value of AZN 1,000 . The Group issued 2,000 ordinary shares (2010: 3,000) at their nominal value in the total amount of AZN 2,000 thousand during 2011. Of these shares, 300 shares were issued and paid for in cash (2010: 1,700 shares) and 1,700 shares were issued and paid for through a transfer from retained earnings (2010: 1,300 shares).

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) Dividends and other distributions

The statutory accounting profit of the Bank is the basis for distributions of profits and other appropriations according to Azerbaijani legislation. Banks are not allowed to pay dividends if net assets are less than Share Capital. Reserves available for distribution amounted to AZN 3,305 thousand as at 31 December 2011 (2010: AZN 3,413 thousand).

Dividends and other distributions provided by the Group during year 2011 and 2010 were as follows:

	2011 AZN	2010 AZN
Dividends per ordinary share (in manats)	70	101
Other distributions per ordinary share (in manats)	85	76
Total distributions per ordinary share (in manats)	<u>155</u>	<u>177</u>

22 Earnings per share

	2011 AZN	2010 AZN
Earnings per share		
Basic and diluted earnings per share (expressed in AZN per share)	<u>147</u>	<u>71</u>

In the financial statements of the Group for the year ended 31 December 2010 the Earnings per share was incorrectly shown as AZN 0.07 per share which is restated to AZN 71 per share by Management.

(a) Basic and diluted earnings per share

The calculation of basic and diluted earnings per share as at 31 December 2011 is based on the profit attributable to ordinary shareholders of AZN 3,156 thousand (2010: AZN 1,285 thousand), and a weighted average number of ordinary shares outstanding of 21,507 (2010: 18,188) calculated as follows.

	2011	2010
Issued ordinary shares at the beginning of the year	20,000	17,000
Effect of shares issued during the year	1,507	1,188
Weighted average number of ordinary shares for the year ended 31 December	<u>21,507</u>	<u>18,188</u>

23 Analysis by segment

In the financial statements for the year ended 31 December 2010 Management disclosed two operating segments which were retail and corporate banking. In 2011 Management revisited this approach, as that information was not used for the purposes of allocating resources. Management believes that the bank has one reportable segment and one strategic business unit which includes loans, deposits and other transactions with customers for the year ended 31 December 2011. (2010: one).

The majority of income from external customers relate to residents of the Republic of Azerbaijan. The majority of non-current assets are located in the Republic of Azerbaijan.

24 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.

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

24 Risk management (Continued)

(b) Market risk (Continued)

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.

(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:

2011 AZN'000	Less than 3 months	From 3 to 6 months	From 6 to 12 months	From 1 to 5 years	More than 5 years	Non interest bearing	Total
Non-derivative assets							
Cash and cash equivalents	1,515	-	-	-	-	26,012	27,527
Available for sale financial assets	5,146	688	1,458	-	-	1,085	8,377
Loans and advances to banks	1,929	195	-	-	-	1,793	3,917
Loans to customers	8,595	10,999	35,258	51,934	6,837	3,374	116,997
Total assets	17,185	11,882	36,716	51,934	6,837	32,264	156,818
Non-derivative liabilities							
Deposits and balances from banks	(517)	(2,000)	(3,500)	(1,180)	-	(101)	(7,298)
Current accounts and deposits from customers	(6,993)	(5,666)	(13,143)	(21,037)	(201)	(39,687)	(86,727)
Other borrowed funds	(6,863)	(1,326)	(2,651)	(28,957)	(7,423)	(194)	(47,414)
Total liabilities	(14,373)	(8,992)	(19,294)	(51,174)	(7,624)	(39,982)	(141,439)
Net position	2,812	2,890	17,422	760	(787)	(7,718)	15,379

24 Risk management (Continued)

(b) Market risk (Continued)

(i) Interest rate gap analysis (Continued)

2010							
AZN'000	Less than 3 months	From 3 to 6 months	From 6 to 12 months	From 1 to 5 years	More than 5 years	Non interest bearing	Total
Non-derivative assets							
Cash and cash equivalents	1,847	-	-	-	-	12,264	14,111
Available for sale financial assets	316	190	126	-	-	910	1,542
Loans and advances to banks	200	-	-	-	-	332	532
Loans to customers	10,871	9,387	20,016	54,462	3,398	2,268	100,402
Total assets	13,234	9,577	20,142	54,462	3,398	15,774	116,587
Non-derivative liabilities							
Deposits and balances from banks	(1,089)	(2,732)	-	(3,501)	-	(796)	(8,118)
Current accounts and deposits from customers	(6,835)	(6,096)	(17,845)	(8,636)	(83)	(15,017)	(54,512)
Other borrowed funds	(6,803)	(1,129)	(2,258)	(25,108)	(5,008)	(76)	(40,382)
Total liabilities	(14,727)	(9,957)	(20,103)	(37,245)	(5,091)	(15,889)	(103,012)
Net position	(1,493)	(380)	39	17,217	(1,693)	(115)	13,575

24 Risk management (Continued)

(b) Market risk (Continued)

(i) Interest rate gap analysis (Continued)

Average interest rates

The table below displays average effective interest rates for interest bearing assets and liabilities as at 31 December 2011 and 2010. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

	2011			2010		
	Average effective interest rate, %			Average effective interest rate, %		
	AZN	USD	Other currencies	AZN	USD	Other currencies
Interest bearing assets						
Cash and cash equivalents	-	8.38%	-	8.00%	4.93%	0.70%
Available for sale financial assets	2.70%	-	-	2.00%	-	-
Loans and advances to banks	13.67%	7.56%	-	12.00%	-	-
Loans to customers	13.00%	18.90%	18.80%	13.10%	18.30%	15.50%
Interest bearing liabilities						
Deposits and balances from banks						
- Vostro accounts	-	-	-	-	-	-
- Term deposits	4.50%	8.00%	3.00%	3.90%	2.30%	-
Current accounts and deposits from customers						
- Current accounts and demand deposits	5.08%	4.36%	5.00%	4.80%	5.60%	5.70%
- Term deposits	13.91%	13.88%	12.29%	13.60%	15.10%	13.00%
Other borrowed funds	2.23%	5.12%	-	1.90%	3.60%	-

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 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 2011 and 2010 is as follows:

	2011	2010
	AZN'000	AZN'000
100 bp parallel fall	(109)	14
100 bp parallel rise	109	(14)

24 Risk management (Continued)

(b) Market risk (Continued)

(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 2011:

	AZN	EUR	USD	Other currencies	Total
	AZN'000	AZN'000	AZN'000	AZN'000	AZN'000
ASSETS					
Cash and cash equivalents	9,127	2,770	14,760	870	27,527
Available for sale financial assets	8,377	-	-	-	8,377
Loans and advances to banks	2,227	637	1,053	-	3,917
Loans to customers	92,084	819	24,094	-	116,997
Other financial assets	35	-	-	-	35
Total assets	111,850	4,226	39,907	870	156,853
LIABILITIES					
Deposits and balances from banks	5,506	1	1,304	487	7,298
Current accounts and deposits from customers	45,258	3,964	37,184	321	86,727
Other borrowed funds	34,226	-	13,188	-	47,414
Other financial liabilities	125	-	-	-	125
Total liabilities	85,115	3,965	51,676	808	141,564
Net position	26,735	261	(11,769)	62	15,289

As at 31 December 2011 the Group has 3 outstanding contracts for purchase of USD in the total amount of USD 11,000 thousand at CBAR rate on the certain dates in 2012. On 31 January 2012 the Group purchased USD 3,000 thousand under one of the contracts, the others will be settled on their contract dates accordingly. The management believes that these settlements will mitigate the open currency gap in 2012.

24 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 2010:

	AZN	EUR	USD	Other currencies	Total
	<u>AZN'000</u>	<u>AZN'000</u>	<u>AZN'000</u>	<u>AZN'000</u>	<u>AZN'000</u>
ASSETS					
Cash and cash equivalents	5,401	1,670	6,982	58	14,111
Available for sale financial assets	1,542	-	-	-	1,542
Loans and advances to banks	532	-	-	-	532
Loans to customers	78,108	1,250	21,044	-	100,402
Other financial assets	19	-	-	-	19
Total financial assets	<u>85,602</u>	<u>2,920</u>	<u>28,026</u>	<u>58</u>	<u>116,606</u>
LIABILITIES					
Deposits and balances from banks	6,125	-	1,993	-	8,118
Current accounts and deposits from customers	28,658	2,726	23,128	-	54,512
Other borrowed funds	35,742	-	4,640	-	40,382
Other financial liabilities	229	-	-	-	229
Total financial liabilities	<u>70,754</u>	<u>2,726</u>	<u>29,761</u>	<u>-</u>	<u>103,241</u>
Net position	<u>14,848</u>	<u>194</u>	<u>(1,735)</u>	<u>58</u>	<u>13,365</u>

A weakening of the AZN, as indicated below, against the following currencies at 31 December 2011 and 2010 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.

	<u>2011</u> <u>AZN'000</u>	<u>2010</u> <u>AZN'000</u>
10% appreciation of USD against AZN	(942)	(139)
10% appreciation of EUR against AZN	21	16

A strengthening of the AZN against the above currencies at 31 December 2011 and 2010 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.

(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.

24 Risk management (Continued)

(c) Credit risk (Continued)

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. 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.

The maximum exposure to financial assets which are subject to credit risk at the reporting date is as follows:

	2011	2010
	AZN'000	AZN'000
ASSETS		
Cash and cash equivalents	13,105	5,507
Available-for-sale debt assets	7,292	632
Loans and advances to banks	2,276	348
Loans to customers	116,997	100,402
Other financial assets	35	19
Total maximum exposure	139,705	106,908

For the analysis of concentration of credit risk in respect of loans to customers refer to note 14.

The maximum exposure to credit risk from unrecognised contractual commitments at the reporting date is presented in Note 26.

24 Risk management (Continued)

(c) Credit risk (Continued)

As at 31 December 2011 the Group has no debtors (2010: 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 honour all cash flow obligations as they become due. The liquidity policy is reviewed and approved by the Management Board.

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 and advances 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.

24 Risk management (Continued)

(d) Liquidity risk (Continued)

The following tables show the undiscounted cash flows on financial liabilities and credit-related commitments on the basis of their earliest possible contractual maturity. The total gross outflow disclosed in the tables is the contractual, undiscounted cash flow on the financial liability or 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.

The maturity analysis for undiscounted financial liabilities as at 31 December 2011 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	7,298	-	-	-	-	7,298	7,298
Current accounts and deposits from customers	74,991	843	2,223	3,766	5,655	87,478	86,727
Other borrowed funds	11,782	1,141	1,672	3,296	37,035	54,926	47,414
Other financial liabilities	125	-	-	-	-	125	125
Total	94,196	1,984	3,895	7,062	42,690	149,827	141,564
Credit related commitments	14,057	-	-	-	-	14,057	14,057

The maturity analysis for undiscounted financial liabilities as at 31 December 2010 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	8,118	-	-	-	-	8,118	8,118
Current accounts and deposits from customers	45,137	774	2,042	3,459	5,194	56,606	54,512
Other borrowed funds	6,208	972	1,424	2,807	35,369	46,780	40,382
Other financial liabilities	229	-	-	-	-	229	229
Total	59,692	1,746	3,466	6,266	40,563	111,733	103,241
Credit related commitments	12,163	-	-	-	-	12,163	12,163

In accordance with Azerbaijani legislation, individuals and legal entities can withdraw their term deposits at any time, losing in most of the cases the accrued interest. Accordingly, these deposits, excluding accrued interest, are shown in the table above in the category of "Demand and less than 1 month".

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.

24 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 2011:

2011 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
Non-derivative assets								
Cash and cash equivalents	26,012	1,515	-	-	-	-	-	27,527
Available for sale financial assets	5,146	688	1,458	-	-	1,085	-	8,377
Loans and advances to banks	2,280	687	556	394	-	-	-	3,917
Loans to customers	3,524	8,445	43,996	49,673	6,837	-	4,522	116,997
Property, equipment and intangible assets	-	-	-	-	-	8,241	-	8,241
Deferred tax asset	-	-	25	-	-	-	-	25
Other assets	35	103	441	101	-	-	-	680
Total assets	36,997	11,438	46,476	50,168	6,837	9,326	4,522	165,764
Non-derivative liabilities								
Deposits and balances from banks	132	486	5,500	1,180	-	-	-	7,298
Current accounts and deposits from customers	40,680	6,000	18,809	21,037	201	-	-	86,727
Other borrowed funds	554	906	3,977	30,235	11,742	-	-	47,414
Current tax liability	-	-	194	-	-	-	-	194
Other liabilities	184	35	24	-	-	-	-	243
Total liabilities	41,550	7,427	28,504	52,452	11,943	-	-	141,876
Net position	(4,553)	4,011	17,972	(2,284)	(5,106)	9,326	4,522	23,888
Cumulative net position up to 5 years	(4,553)	(542)	17,430	15,146				

24 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 2010:

2010 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
Non-derivative assets								
Cash and cash equivalents	12,264	1,847	-	-	-	-	-	14,111
Available for sale financial assets	316	190	126	-	-	910	-	1,542
Loans and advances to banks	63	11	271	187	-	-	-	532
Loans to customers	8,445	4,694	26,853	51,913	3,398	-	5,099	100,402
Property, equipment and intangible assets	-	-	-	-	-	7,954	-	7,954
Deferred tax asset	376	-	-	-	-	-	-	376
Other assets	100	100	119	-	-	-	-	319
Total assets	21,564	6,842	27,369	52,100	3,398	8,864	5,099	125,236
Non-derivative liabilities								
Deposits and balances from banks	519	1,366	2,732	3,501	-	-	-	8,118
Current accounts and deposits from customers	18,804	3,048	23,941	8,636	83	-	-	54,512
Other borrowed funds	472	772	3,386	25,751	10,001	-	-	40,382
Current tax liability	-	-	78	-	-	-	-	78
Other liabilities	229	-	93	-	-	-	-	322
Total liabilities	20,024	5,186	30,230	37,888	10,084	-	-	103,412
Net position	1,540	1,656	(2,861)	14,212	(6,686)	8,864	5,099	21,824
Cumulative net position up to 5 years	1,540	3,196	335	14,547				

As at 31 December 2011, other borrowed funds with a total value of AZN 11,110 thousand (2010: AZN 5,636 thousand) had been subject to breaches of covenants, and were therefore contractually repayable on demand. But the Group does not expect the financial institutions to whom these borrowings are payable to exercise their right to immediate repayment. In the above tables these borrowings have been classified according to their original contractual maturity.

24 Risk management (Continued)

(d) Liquidity risk (Continued)

Although in accordance with Azerbaijani legislation term deposits can be withdrawn at any time with customers in most cases forfeiting accrued interest, in the above tables term deposits are classified according to their stated maturity date which are the date that the Group expects these deposits to be redeemed.

25 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 (2010: 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 2011, this minimum level is 12% (31 December 2010: 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 Management believes that the Bank was in compliance with the statutory capital ratio during the years ended 31 December 2011 and 2010.

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

	2011 AZN'000	2010 AZN'000
Primary capital	24,600	22,405
Total capital	24,600	22,405
Risk-weighted assets	149,214	125,441
Capital adequacy ratio (%)	16.49%	17.86%

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.

25 Capital management (Continued)

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

	2011 AZN'000	2010 AZN'000
Tier 1 capital		
Share capital	22,000	20,000
Retained earnings	1,178	1,114
Less: Intangible assets	(68)	(77)
Total tier 1 capital	23,110	21,037
Tier 2 capital		
Reserves	1,865	1,568
Asset revaluation reserve	710	710
Total tier 2 capital	2,575	2,278
Less: Investment	(1,085)	(910)
Total capital	24,600	22,405
Risk-weighted assets		
On-balance sheet	134,984	113,278
Off-balance sheet	14,230	12,163
Total risk weighted assets	149,214	125,441
Total capital expressed as a percentage of risk-weighted assets (total capital ratio)	16.49%	17.86%
Total tier 1 capital expressed as a percentage of risk-weighted assets (tier 1 capital ratio)	15.49%	16.77%

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 management believes that the Group has complied with all externally imposed capital requirements during the years ended 31 December 2011 and 2010.

26 Commitments

The Group has outstanding commitments to extend loans. These 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 commitments are set out in the following table by category. The amounts reflected in the table for 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.

	2011 AZN'000	2010 AZN'000
Contracted amount		
Loan and credit line commitments	9,605	7,569
Guarantees and letters of credit	4,452	4,594
	14,057	12,163

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

27 Operating leases

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. All rentals of the Group are cancellable.

28 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. There remains a risk that the loss or destruction of certain assets could have a material adverse effect on operations and financial position.

(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 is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are often unclear, contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by various levels of authorities, which have the authority to impose severe fines and interest charges. A tax year generally remains open for review by the tax authorities for three subsequent calendar years; however, under certain circumstances a tax year may remain open longer.

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

29 Related party transactions

(a) Control relationships

There is no 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 2011 and 2010 is as follows:

	2011 AZN'000	2010 AZN'000
Short term employee benefits	314	226

These amounts include non-cash benefits in respect of the members of the Supervisory Board and the Management Board.

The outstanding balances and average interest rates as at 31 December 2011 and 2010 for transactions with the members of the Supervisory Board and the Management Board are as follows:

	2011 AZN'000	Average interest rate, %	2010 AZN'000	Average interest rate, %
Consolidated statement of financial position				
ASSETS				
Loans to customers	144	6%	201	9%
Loan impairment allowance	(3)		(3)	
LIABILITIES				
Current accounts and deposits from customers	(1,224)	-	(76)	16%

The loans are in AZN and repayable between years 2012 and 2032.

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

	2011 AZN'000	2010 AZN'000
Profit or loss		
Interest income	8	27
Interest expense	5	-
Impairment losses	-	3

29 Related party transactions (Continued)

(c) Transactions with other shareholders

In addition to its related party disclosures, the Bank discloses outstanding balances and the related average interest rates as at 31 December 2011 and related profit or loss amounts of transactions for the year ended 31 December 2011 with other shareholders (holding 5% or more of shares of the Bank):

	2011	Average
	AZN'000	interest
		rate, %
Consolidated statement of financial position		
ASSETS		
Loans to customers		
Principal balance		
-In AZN	206	15%
-In USD	10	26%
Impairment allowance	(5)	
LIABILITIES		
Current accounts and deposits from customers		
-In AZN	1,006	14%
-In USD	-	-
Profit (loss)		
Interest income	36	
Interest expense	(76)	
Fee and commission income	2	
Impairment losses	(5)	
Other general and administrative expenses	(62)	

Both deposits and loans mature between 2012 and 2016.

The outstanding balances and the related average interest rates as at 31 December 2010 and related profit or loss amounts of transactions for the year ended 31 December 2010 with other shareholders are as follows:

	2010	Average
	AZN'000	interest
		rate, %
Consolidated statement of financial position		
ASSETS		
Loans to customers		
Principal balance		
-In AZN	392	15%
-In USD	6	26%
Impairment allowance	-	
LIABILITIES		
Current accounts and deposits from customers		
-In AZN	7	-
Profit (loss)		
Interest income	34	
Other general and administrative expenses	(55)	

30 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 2011:

AZN '000	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying amount	Fair value
Cash and cash equivalents	27,527	-	-	27,527	27,527
Available-for-sale financial assets	-	8,377	-	8,377	8,377
Loans and advances to banks	3,917	-	-	3,917	3,917
Loans to customers:					
Loans to corporate customers	54,548	-	-	54,548	58,684
Loans to retail customers	62,449	-	-	62,449	64,032
Other financial assets	35	-	-	35	35
	148,476	8,377	-	156,853	162,572
Deposits and balances from banks	-	-	7,298	7,298	7,298
Current accounts and deposits from customers	-	-	86,727	86,727	87,755
Other borrowed funds	-	-	47,414	47,414	48,736
Other financial liabilities	-	-	125	125	125
	-	-	134,266	141,564	143,914

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at 31 December 2010:

AZN '000	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying amount	Fair value
Cash and cash equivalents	14,111	-	-	14,111	14,111
Available-for-sale financial assets	-	1,542	-	1,542	1,542
Loans and advances to banks	532	-	-	532	532
Loans to customers:					
Loans to corporate customers	50,783	-	-	50,783	54,634
Loans to retail customers	49,619	-	-	49,619	50,877
Other financial assets	19	-	-	19	19
	115,064	1,542	-	116,606	121,715
Deposits and balances from banks	-	-	8,118	8,118	8,118
Current accounts and deposits from customers	-	-	54,512	54,512	55,158
Other borrowed funds	-	-	40,382	40,382	41,507
Other financial liabilities	-	-	229	229	229
	-	-	103,241	103,241	105,012

The Management of the Group believes that funds borrowed from government institutions are stated at fair value on inception, as these instruments represent a separate market segment which is specific to the Azerbaijani market.

30 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 amount for which a financial instrument can be exchanged between knowledgeable, willing parties in an arm's length transaction. 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 settlement of liabilities.

(b) Fair value hierarchy

The Group measures fair values for financial instruments recorded on the statement of financial position 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. The Group has no such instruments.
- Level 2: Valuation techniques based on observable inputs, 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 identical or 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. The Group has purchased debt securities which are traded but not actively. Management checks the fair value of these instruments by obtaining recent market prices for similar categories of debt instruments.
- Level 3: Valuation techniques using significant unobservable inputs. 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 Group has no such instruments.

The table below analyses financial instruments measured at fair value at 31 December 2011, by the level in the fair value hierarchy into which the fair value measurement is categorised:

AZN '000	Level 2
Available-for-sale financial assets	
- Debt and other fixed income instruments	7,292

The table below analyses financial instruments measured at fair value at 31 December 2010, by the level in the fair value hierarchy into which the fair value measurement is categorised:

AZN '000	Level 2
Available-for-sale financial assets	
- Debt and other fixed income instruments	632

31 Events after the reporting period

On 27 February 2012 the Group increased its share capital from AZN 22,000 thousand to AZN 23,804 thousand; transferring AZN 1,804 thousand out of its profit for the year ended 31 December 2011 to share capital.