

**TURANBANK OPEN
JOINT- STOCK COMPANY**

**Consolidated Financial Statements
for the year ended 31 December 2012**

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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 2012, 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 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG Azerbaijan Limited

18 March 2013

TuranBank OJSC
Consolidated Statement of Comprehensive Income for the year ended 31 December 2012

	Notes	2012 AZN'000	2011 AZN'000
Interest income	4	19,052	15,908
Interest expense	4	(9,728)	(8,037)
Net interest income		9,324	7,871
Fee and commission income	5	3,300	2,181
Fee and commission expense	6	(510)	(349)
Net fee and commission income		2,790	1,832
Net gain from trading in foreign currencies		896	514
Net foreign exchange income		18	68
Other operating income		31	69
Operating income		13,059	10,354
Impairment losses	13	(1,559)	(1,037)
Personnel expenses	7	(3,942)	(3,135)
Other general administrative expenses	8	(3,545)	(2,337)
Profit before income tax		4,013	3,845
Income tax expense	9	(827)	(689)
Profit for the year		3,186	3,156
Other comprehensive income, net of income tax			
Revaluation reserve for available-for-sale financial assets:			
- Net change in fair value		20	-
Other comprehensive income for the year, net of income tax		20	-
Total comprehensive income for the year		3,206	3,156
Earnings per share for profit attributable to the equity holders of the Bank during the year (expressed in AZN per share):			
- Basic	21	138	147

The consolidated financial statements as set out on pages 4 to 66 were approved by management on 18 March 2013 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 2012

	Notes	2012 AZN'000	2011 AZN'000
ASSETS			
Cash and cash equivalents	10	36,305	27,527
Available-for-sale financial assets			
- Held by the Group	11	1,649	7,377
- Pledged under sale and repurchase agreements	11	-	1,000
Loans and advances to banks	12	7,215	3,917
Loans to customers	13	161,279	116,997
Property, equipment and intangible assets	14	9,611	8,241
Deferred tax asset	9	-	25
Other assets	15	1,014	680
Total assets		217,073	165,764
LIABILITIES			
Deposits and balances from banks	16	25,531	7,298
Current accounts and deposits from customers	17	102,760	86,727
Other borrowed funds	18	56,199	47,414
Current tax liability		329	194
Deferred tax liability	9	32	-
Other liabilities	19	352	243
Total liabilities		185,203	141,876
EQUITY			
Share capital	20	30,001	22,000
Revaluation surplus for buildings		667	710
Revaluation reserve for available-for-sale financial assets		20	-
Retained earnings		1,182	1,178
Total equity		31,870	23,888
Total liabilities and equity		217,073	165,764

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 2012

	Notes	2012 AZN'000	2011 AZN'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest receipts		18,456	14,748
Interest payments		(9,320)	(7,149)
Fee and commission receipts		3,300	2,181
Fee and commission payments		(510)	(349)
Net receipts from foreign exchange		896	514
Dividends received		24	40
Other income receipts		7	29
Other general administrative expenses payments		(6,786)	(4,882)
(Increase)/ decrease in operating assets			
Loans and advances to banks		(3,272)	(3,379)
Loans to customers		(45,273)	(16,486)
Other assets		(321)	(348)
Increase/ (decrease) in operating liabilities			
Deposits and balances from banks		18,191	(915)
Current accounts and deposits from customers		15,813	31,500
Other liabilities		68	(79)
Net cash (used in)/ provided from operating activities before income tax paid			
		(8,727)	15,425
Income tax paid		(635)	(222)
Cash flows (used in)/ from operations			
		(9,362)	15,203
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of available-for-sale financial assets		-	(7,439)
Sale and repayment of available-for-sale financial assets		6,753	621
Purchases of property and equipment and intangible assets		(2,007)	(904)
Sales of property and equipment and intangible assets		2	-
Cash flows from/ (used in) investing activities			
		4,748	(7,722)
CASH FLOWS FROM FINANCING ACTIVITIES			
Receipts of other borrowed funds		20,126	14,937
Repayment of other borrowed funds		(11,670)	(7,949)
Proceeds from issuance of share capital		6,197	300
Dividends paid		(1,279)	(1,392)
Cash flows from financing activities			
		13,374	5,896
Net increase in cash and cash equivalents			
		8,760	13,377
Effect of changes in exchange rates on cash and cash equivalents		18	39
Cash and cash equivalents as at the beginning of the year		27,527	14,111
Cash and cash equivalents as at the end of the year	10	36,305	27,527

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

TuranBank OJSC
Consolidated Statement of Changes in Equity for the year ended 31 December 2012

AZN'000	Share capital	Revaluation surplus for buildings	Revaluation reserve for available- for-sale financial assets	Retained earnings	Total
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 20)	300	-	-	-	300
Transfer of profit and issue of share capital (Note 20)	1,700	-	-	(1,700)	-
Dividends declared (Note 20)	-	-	-	(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
Balance as at 1 January 2012	22,000	710	-	1,178	23,888
Total comprehensive income					
Profit for the year	-	-	-	3,186	3,186
Other comprehensive income					
Net change in fair value of available-for-sale financial assets, net of income tax	-	-	20	-	20
Depreciation of revaluation reserve	-	(43)	-	43	-
Total other comprehensive income	-	(43)	20	43	20
Total comprehensive income for the year	-	(43)	20	3,229	3,206
Transactions with owners, recorded directly in equity					
Shares issued (Note 20)	6,197	-	-	-	6,197
Transfer of profit and issue of share capital (Note 20)	1,804	-	-	(1,804)	-
Dividends declared (Note 20)	-	-	-	(1,421)	(1,421)
Total transactions with owners	8,001	-	-	(3,225)	4,776
Balance as at 31 December 2012	30,001	667	20	1,182	31,870

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

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 subsidiary is a leasing company.

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

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

Deposits with interest yield above 12% are not covered by the programme.

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

The Bank has thirteen branches and one sub-branch (2011: thirteen branches) within the Republic of Azerbaijan. Six branches are located in Baku, seven branches and one sub-branch are located in other regions of Azerbaijan. The majority of the assets and liabilities are located in the Republic of Azerbaijan.

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

(b) Shareholders

As at 31 December 2012 the Bank has 27 shareholders each having less than 10% ownership. The Bank has no ultimate controlling party who has the power to direct the transactions of the Group at his own discretion and for his own benefit.

(c) Business environment

Azerbaijan business environment

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

2 Basis of preparation

(a) Statement of compliance

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

(b) Basis of measurement

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

(c) Functional and presentation currency

The functional currency of the 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 judgments

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

- loan impairment estimates - note 13
- estimates of fair values of financial instruments – note 29
- building revaluation estimates - note 14

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 loans 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 them for the foreseeable future or until maturity. Other financial instruments may be reclassified out of at fair value through profit or loss category only in rare circumstances. Rare circumstances arise from a single event that is unusual and highly unlikely to recur in the near term.

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

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

3 Significant accounting policies, continued

(d) Financial instruments, continued

(i) Classification, continued

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

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

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

(ii) Recognition

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

(iii) Measurement

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

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

- loans and receivables which are measured at amortized cost using the effective interest method
- held-to-maturity investments that are measured at amortized cost using the effective interest method
- investments in equity instruments that do not have a quoted market price in an active market and whose fair value 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 amortized cost.

3 Significant accounting policies, continued

(d) Financial instruments, continued

(iv) *Amortised cost*

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

(v) *Fair value measurement principles*

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's 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.

3 Significant accounting policies, continued

(d) Financial instruments, continued

(vi) *Gains and losses on subsequent measurement*

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

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

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

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

(vii) *Derecognition*

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

3 Significant accounting policies, continued

(d) Financial instruments, continued

(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 recognized in profit or loss over the term of the repo agreement using the effective interest method.

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 recognized 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.

3 Significant accounting policies, continued

(e) Property and equipment, continued

(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
- leasehold improvement	14 years
- fixtures and fittings	5 years
- other fixed assets	5 years
- equipment	4 years

(f) Intangible assets

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

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

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

(g) Impairment

(i) Financial assets carried at amortized cost

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

3 Significant accounting policies, continued

(g) Impairment, continued

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

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 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.

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

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

(ii) *Financial assets carried at cost*

Financial assets carried at cost include unquoted equity instruments included in available-for-sale financial assets that are not carried at fair value because their fair value 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 recognized in profit or loss and can not be reversed.

3 Significant accounting policies, continued

(g) Impairment, continued

(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.

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

3 Significant accounting policies, continued

(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.

Loan commitments are not recognised, except for the followings:

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

(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.

3 Significant accounting policies, continued

(j) Share capital, continued

(ii) Dividends

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

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

(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.

(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 amortized to interest income over the estimated life of the financial instrument using the effective interest method.

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

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

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

3 Significant accounting policies, continued

(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) 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 2012, 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.

- Amendments to IFRS 7 *Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities* contain new disclosure requirements for financial assets and liabilities that are offset in the statement of financial position or subject to master netting arrangements or similar agreements. The amendments are effective for annual periods beginning on or after 1 January 2013, and are to be applied retrospectively. The new standard will not have any impact on financial position or performance.
- 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 remaining parts of the standard are expected to be issued during 2013. The Group recognises that the new standard introduces many changes to the accounting for financial instruments and is likely to have a significant impact on the consolidated financial statements. The impact of these changes will be analysed during the course of the project as further phases of the standard are issued. The Group does not intend to adopt this standard early.
- IFRS 10 *Consolidated Financial Statements* will be effective for annual periods beginning on or after 1 January 2013. The new standard supersedes IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities*. IFRS 10 introduces a single control model which includes entities that are currently within the scope of SIC-12. Under the new three-step control model, an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with that investee, has the ability to affect those returns through its power over that investee and there is a link between power and returns. Consolidation procedures are carried forward from IAS 27 (2008). When the adoption of IFRS 10 does not result in a change in the previous consolidation or non-consolidation of an investee, no adjustments to accounting are required on initial application. When the adoption results in a change in the consolidation or non-consolidation of an investee, the new standard may be adopted with either full retrospective application from date that control was obtained or lost or, if not practicable, with limited retrospective application from the beginning of the earliest period for which the application is practicable, which may be the current period. Early adoption of IFRS 10 is permitted provided an entity also early-adopts IFRS 11, IFRS 12, IAS 27 (2011) and IAS 28 (2011). The Group has not yet analysed the likely impact of the new standard on its financial position or performance.

3 Significant accounting policies, continued

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

- 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. The Group has not yet analysed the likely impact of the new standard on its financial position or performance.
- 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. The new standard will not have any impact on financial position or performance.
- Various *Improvements to IFRSs* have been dealt with on a standard-by-standard basis. All amendments, which result in accounting changes for presentation, recognition or measurement purposes, will come into effect not earlier than 1 January 2013. The Group has not yet analysed the likely impact of the improvements on its financial position or performance.

4 Net interest income

	2012 AZN'000	2011 AZN'000
Interest income		
Loans to customers	18,700	15,445
Loans and advances to banks	238	397
Available-for-sale financial assets	92	66
Cash and cash equivalents	22	-
	19,052	15,908
Interest expense		
Current accounts and deposits from customers	7,210	6,519
Other borrowed funds	1,834	1,185
Deposits and balances from banks	684	333
	9,728	8,037
	9,324	7,871

Included within various line items under interest income for the year ended 31 December 2012 is a total of AZN 2,029 thousand (2011: AZN 1,102 thousand) accrued on impaired financial assets.

5 Fee and commission income

	2012	2011
	AZN'000	AZN'000
Cash withdrawal	1,863	995
Annual credit card maintenance	428	385
Guarantee and letter of credit issuance	370	297
Servicing customers accounts	356	275
Foreign exchange	278	225
Settlement	3	2
Other	2	2
	3,300	2,181

6 Fee and commission expense

	2012	2011
	AZN'000	AZN'000
Annual credit card maintenance	191	167
Cash collection	157	25
Servicing corresponding accounts	99	80
Guarantee and letter of credit issuance	43	69
Other	20	8
	510	349

7 Personnel expenses

	2012	2011
	AZN'000	AZN'000
Employee compensation	3,235	2,575
Payments to Social Security Fund	707	560
	3,942	3,135

8 Other general administrative expenses

	2012 AZN'000	2011 AZN'000
Advertising and marketing	953	382
Depreciation and amortization (Note 14)	693	590
Security	290	236
Professional services	246	210
Communications and information services	239	214
Operating lease expense	222	152
Repairs and maintenance	159	130
Taxes other than on income	135	76
Office supplies	131	72
Utilities	51	44
Travel expenses	40	55
Insurance	35	16
Other	351	160
	3,545	2,337

9 Income tax expense

	2012 AZN'000	2011 AZN'000
Current year tax expense	775	338
Deferred taxation movement due to origination and reversal of temporary differences and movement in valuation allowance	52	351
Total income tax expense	827	689

In 2012, the applicable tax rate for current and deferred tax is 20% (2011: 20%).

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

	2012 AZN'000	%	2011 AZN'000	%
Profit before tax	4,013		3,845	
Income tax at the applicable tax rate	803	20%	769	20%
Transfer to share capital	-		(361)	(9%)
Correction of prior year error	-		267	7%
Non-deductible costs	29	1%	22	1%
Non-taxable income	(5)	0%	(8)	0%
	827	21%	689	19%

9 Income tax expense, continued

(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 2012 and 2011 are presented as follows.

2012	Recognised in other comprehensive income			
	Balance 1 January 2012	Recognised in profit or loss	Recognised in other comprehensive income	Balance 31 December 2012
AZN'000				
Available-for-sale financial assets	-	-	(5)	(5)
Loans to customers	484	7	-	491
Property, equipment and intangible assets	(428)	(29)	-	(457)
Other assets	(14)	(41)	-	(55)
Other liabilities	(17)	11	-	(6)
	25	(52)	(5)	(32)

2011

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

(b) Income tax recognised in other comprehensive income

The tax effects relating to components of other comprehensive income for the years ended 31 December 2012 and 2011 comprise the following:

	2012			2011		
	Amount before tax	Tax expense	Amount net-of-tax	Amount before tax	Tax expense	Amount net-of-tax
AZN'000						
Net change in fair value of available-for-sale financial assets	25	(5)	20	-	-	-
Other comprehensive income	25	(5)	20	-	-	-

10 Cash and cash equivalents

	2012 AZN'000	2011 AZN'000
Cash on hand	8,850	8,292
Nostro accounts with the CBAR	13,886	6,130
Nostro accounts with other banks		
- rated AAA	2,361	-
- rated A- to A+	9,447	6,161
- rated BBB	2	12
- rated from BB- to BB+	264	154
- rated below B+	1,195	1,588
- not rated	300	3,674
Total nostro accounts with other banks	13,569	11,589
Cash equivalents		
- Term deposits with other banks		
- rated from BB- to BB+	-	529
- not rated	-	987
Total term deposits with other banks	-	1,516
Total cash equivalents	-	1,516
Total cash and cash equivalents	36,305	27,527

No cash and cash equivalents are impaired or past due.

As at 31 December 2012 the Group has two banks (2011: two banks), whose balances exceed 10% of equity. The gross value of these balances as at 31 December 2012 is AZN 19,846 thousand (2011: AZN 10,246 thousand).

11 Available-for-sale financial assets

	2012 AZN'000	2011 AZN'000
Held by the Group		
Debt and other fixed-income instruments		
- Government and municipal bonds		
Notes issued by Mortgage Fund of the Republic of Azerbaijan	337	2,050
Treasury bills of the Ministry of Finance of the Republic of Azerbaijan	202	242
Notes issued by CBAR	-	4,000
Total government and municipal bonds	539	6,292
Equity investments		
- Corporate shares at cost	1,110	1,085
	1,649	7,377
Pledged under sale and repurchase agreements		
- Notes issued by CBAR		
rated from BB- to BB+	-	1,000
	1,649	8,377

11 Available-for-sale financial assets, continued

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

Investments without a determinable fair value

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

12 Loans and advances to banks

	2012 AZN'000	2011 AZN'000
Mandatory reserve with the CBAR	2,803	1,641
Loans and deposits		
rated from BB- to BB+	8	8
not rated	4,404	2,268
Total loans and deposits	7,215	3,917

No loans and advances to banks are impaired or past due.

(a) Concentration of loans and advances to banks

As at 31 December 2012 the Group has no banks (2011: no banks), whose balances exceed 10% of equity.

(b) Mandatory reserve with the CBAR

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

13 Loans to customers

	2012 AZN'000	2011 AZN'000
Loans to corporate customers		
Loans to large corporates	47,987	22,416
Loans to small and medium size companies	26,409	36,724
Total loans to corporate customers	74,396	59,140
Loans to retail customers		
Loans to entrepreneurs	58,291	21,563
Consumer loans	22,790	28,152
Mortgage loans	12,320	9,621
Other	1,999	5,474
Total loans to retail customers	95,400	64,810
Gross loans to customers	169,796	123,950
Impairment allowance	(8,517)	(6,953)
Net loans to customers	161,279	116,997

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

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

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 AZN'000	Loans to retail customers AZN'000	Total AZN'000
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	4,593	2,360	6,953

13 Loans to customers, continued

(a) Credit quality of loans to customers

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

	Gross loans AZN'000	Impairment allowance AZN'000	Net loans AZN'000	Impairment allowance to gross loans, %
Loans to corporate customers				
Loans to large corporates				
Loans without individual signs of impairment	47,987	1,122	46,865	2%
Total loans to large corporates	47,987	1,122	46,865	2%
Loans to small and medium size companies				
Loans without individual signs of impairment	20,345	426	19,919	2%
Overdue or impaired loans:				
- not overdue	322	171	151	53%
- overdue more than 90 days and less than 1 year	354	73	281	21%
- overdue more than 1 year	5,388	2,688	2,700	50%
Total overdue or impaired loans	6,064	2,932	3,132	48%
Total loans to small and medium size companies	26,409	3,358	23,051	13%
Total loans to corporate customers	74,396	4,480	69,916	6%
Loans to retail customers				
Loans to entrepreneurs				
Loans without individual signs of impairment	51,851	1,090	50,761	2%
Overdue or impaired loans:				
- not overdue	2,485	465	2,020	19%
- overdue more than 90 days and less than 1 year	1,183	265	918	22%
- overdue more than 1 year	2,772	1,291	1,481	47%
Total overdue or impaired loans	6,440	2,021	4,419	31%
Total loans to entrepreneurs	58,291	3,111	55,180	5%

13 Loans to customers, continued

(a) Credit quality of loans to customers, continued

	Gross loans AZN'000	Impairment allowance AZN'000	Net loans AZN'000	Impairment allowance to gross loans, %
Consumer loans				
Loans without individual signs of impairment	21,645	247	21,398	1%
Overdue or impaired loans:				
- overdue more than 90 days and less than 1 year	61	32	29	52%
- overdue more than 1 year	1,084	647	437	60%
Total overdue or impaired loans	1,145	679	466	59%
Total consumer loans	22,790	926	21,864	4%
Mortgage loans				
Loans without individual signs of impairment	12,313	-	12,313	0%
Overdue or impaired loans:				
- overdue more than 90 days and less than 1 year	7	-	7	0%
Total overdue or impaired loans	7	-	7	0%
Total mortgage loans	12,320	-	12,320	0%
Other loans				
Loans without individual signs of impairment	1,999	-	1,999	0%
Total other loans	1,999	-	1,999	0%
Total loans to retail customers	95,400	4,037	91,363	4%
Total loans to customers	169,796	8,517	161,279	5%

13 Loans to customers, continued

(a) Credit quality of loans to customers, continued

The following table provides information on the credit quality of the loans to customers as at 31 December 2011:

	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	22,412	537	21,875	2%
Overdue or impaired loans:				
- overdue less than 90 days	4	-	4	-
Total overdue or 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%
Overdue or 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 overdue or 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 entrepreneurs				
Loans without individual signs of impairment	20,288	449	19,839	2%
Overdue or 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 overdue or impaired loans	1,275	421	854	33%
Total loans to entrepreneurs	21,563	870	20,693	4%
Consumer loans				
Loans without individual signs of impairment	26,749	709	26,040	3%
Overdue or impaired loans:				
- overdue less than 90 days	1,023	262	761	26%
- overdue more than 1 year	380	60	320	16%
Total overdue or impaired loans	1,403	322	1,081	23%
Total consumer loans	28,152	1,031	27,121	4%

13 Loans to customers, continued

(a) Credit quality of loans to customers, continued

	Gross loans AZN'000	Impairment allowance AZN'000	Net loans AZN'000	Impairment allowance to gross loans, %
Mortgage loans				
Loans without individual signs of impairment	9,600	226	9,374	2%
Overdue or impaired loans:				
- overdue less than 90 days	21	3	18	14%
Total overdue or impaired loans	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%
Overdue or impaired loans:				
- overdue less than 90 days	355	48	307	14%
- overdue more than 90 days and less than 1 year	6	1	5	17%
- overdue more than 1 year	518	72	446	14%
Total overdue or 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%

As at 31 December 2012 included in the loan portfolio are renegotiated loans to customers that would otherwise be past due or impaired of AZN 2,038 thousand (2011: AZN 309 thousand). Such restructuring activity is aimed at managing customer relationships and maximising collection opportunities. Renegotiated loans are included in the category of assets without individual signs of impairment in the tables above, unless the borrower fails to comply with the renegotiated terms.

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

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

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

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

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

- overdue payments under the loan agreement.

13 Loans to customers, continued

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

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 and which gross loan balances outstanding of less than AZN 100,000, management makes the following key assumptions:

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

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

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

Changes in these estimates could effect the loan impairment provision. For example, to the extent that the net present value of the estimated cash flows differs by one percent, the impairment allowance on loans to customers as at 31 December 2012 would be AZN 1,613 thousand lower/higher (2011: AZN 1,170 thousand lower/higher).

(c) Analysis of collateral and other credit enhancements

The following table provides an analysis of loans to customers, net of impairment, by types of collateral as at 31 December 2012 and 2011:

	2012	% of loan	2011	% of loan
	AZN'000	portfolio	AZN'000	portfolio
Real estate	94,941	59%	79,812	68%
Guarantee letters	17,309	11%	7,934	7%
Equipment	7,444	4%	4,062	3%
Cash and deposits	6,147	4%	3,240	3%
Motor vehicles	6,089	4%	4,276	4%
Jewellery	2,338	1%	4,604	4%
Securities	1,090	1%	2,709	2%
Other collateral	6,594	4%	3,849	3%
No collateral or other credit enhancements	19,327	12%	6,511	6%
	161,279	100%	116,997	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.

13 Loans to customers, continued

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

(i) Loans to corporate customers

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

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

13 Loans to customers, continued

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

(i) Loans to corporate customers, continued

31 December 2011 AZN'000	Loans to customers, carrying amount	Fair value of collateral - for collateral assessed as of inception date
Loans without individual signs of impairment		
Cash and deposits	287	287
Real estate	31,523	23,003
Motor vehicles	17	17
Equipment	6,414	5,387
Other collateral (Inventory)	1,674	1,186
Guarantee letters	920	-
Securities	134	-
No collateral or other credit enhancement	9,616	-
Total loans without individual signs of impairment	50,585	29,880
Overdue or impaired loans		
Real estate	2,188	2,054
Motor vehicles	129	129
Equipment	521	521
Guarantee letters	98	-
No collateral or other credit enhancement	1,026	-
Total overdue or impaired loans	3,962	2,704
Total loans to corporate customers	54,547	32,584

13 Loans to customers, continued

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

(ii) Loans to entrepreneurs

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

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

13 Loans to customers, continued

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

(ii) Loans to entrepreneurs, continued

31 December 2011 AZN'000	Loans to customers, carrying amount	Fair value of collateral - for collateral assessed as of inception date
Loans without individual signs of impairment		
Cash and deposits	309	309
Real estate	15,939	13,514
Motor vehicles	980	980
Equipment	539	530
Other collateral (Inventory)	35	35
Guarantee letters	88	-
No collateral or other credit enhancement	1,949	-
Total loans without individual signs of impairment	19,839	15,368
Overdue or impaired loans		
Cash and deposits	1	1
Real estate	799	736
No collateral or other credit enhancement	54	-
Total overdue or impaired loans	854	737
Total loans to entrepreneurs	20,693	16,105

13 Loans to customers, continued

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

(ii) Loans to entrepreneurs, continued

The tables above are presented on the basis of excluding overcollateralization.

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

Fair value of collateral was assessed at the loan inception date and it was not updated for further changes for all loans of the group.

Information on valuation of collateral is based on when this estimate was made, if any.

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

(iii) Loans to other retail customers

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

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

31 December 2012 AZN'000	Loans to customers, carrying amount	Fair value of collateral - for collateral assessed as of inception date
Not overdue loans	12,313	12,298
Overdue loans	7	7
Total mortgage loans	12,320	12,305
31 December 2011 AZN'000	Loans to customers, carrying amount	Fair value of collateral - for collateral assessed as of inception date
Not overdue loans	9,374	8,982
Overdue loans	18	18
Total mortgage loans	9,392	9,000

The table above is presented on the basis of excluding overcollateralization.

For certain mortgage loans the Group updates the appraised values of collateral obtained at inception of the loan to the current values considering the approximate changes in property values. For other mortgage loans, the fair value of collateral was estimated at inception of the loans and was not adjusted for subsequent changes to the reporting date.

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

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

13 Loans to customers, continued

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

(iv) Repossessed collateral

During the year ended 31 December 2012, the Group obtained certain assets by taking possession of collateral for fully provisioned loans to customers with a gross amount of AZN 220 thousand (2011: AZN 14 thousand). As at 31 December 2012, the repossessed collateral comprises:

	2012 AZN'000	2011 AZN'000
Real estate	579	237
Total repossessed collateral	579	237

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

(d) Industry and geographical analysis of the loan portfolio

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

	2012 AZN'000	2011 AZN'000
Trade and services	54,357	21,288
Manufacturing	30,709	26,412
Construction	24,328	9,347
Agriculture	18,312	23,287
Other	6,980	5,843
Loans to retail customers	35,110	37,773
	169,796	123,950
Impairment allowance	(8,517)	(6,953)
	161,279	116,997

(e) Significant credit exposures

As at 31 December 2012 the Group has seven borrowers or groups of connected borrowers (2011: seven), whose loan balances exceed 10% of equity. The gross value of these loans as at 31 December 2012 is AZN 30,612 thousand (2011: AZN 24,915 thousand).

(f) Loan maturities

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

14 Property, equipment and intangible assets

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

14 Property, equipment and intangible assets, continued

AZN'000	Buildings	Leasehold improvement	Equipment	Fixtures and fittings	Other fixed assets	Computer software	Total
Cost/revalued amount							
Balance at 1 January 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 and impairment losses							
Balance at 1 January 2011	-	(39)	(337)	(566)	(148)	(93)	(1,183)
Depreciation 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 amounts							
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

There are no capitalised borrowing costs related to the acquisition or construction of plant and equipment during 2012 (2011: nil).

(a) Revalued assets

There was no revaluation during 2012. 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 2012, if the buildings would not have been revalued, would be AZN 5,569 thousand (2011: AZN 5,775 thousand).

15 Other assets

	2012 AZN'000	2011 AZN'000
Other receivables	106	35
Total other financial assets	106	35
Repossessed collateral	579	237
Prepayments	158	285
Tax settlements, other than income tax	68	80
Sundry receivables	45	9
Other	58	34
Total other non-financial assets	908	645
Total other assets	1,014	680

16 Deposits and balances from banks

	2012 AZN'000	2011 AZN'000
Vostro accounts	319	36
Term deposits	25,212	7,262
	25,531	7,298

As at 31 December 2012 the Group has three banks (2011: one banks), whose balances exceed 10% of equity. The gross value of these balances as at 31 December 2012 are AZN 18,649 thousand (2011: AZN 5,500 thousand).

17 Current accounts and deposits from customers

	2012 AZN'000	2011 AZN'000
Current accounts and demand deposits		
- Retail	8,133	9,415
- Corporate	32,914	24,186
- Retail	49,681	41,813
- Corporate	12,032	11,313
	102,760	86,727

As at 31 December 2012, the Group maintained customer deposit balances of AZN 9,873 thousand (2011: AZN 10,183 thousand) that serve as collateral for loans and unrecognized credit instruments granted by the Group.

As at 31 December 2012, the Group has three customers (2011: three customers), whose balances exceed 10% of equity. These balances as at 31 December 2012 are AZN 37,280 thousand (2011: AZN 22,688 thousand).

18 Other borrowed funds

	2012 AZN'000	2011 AZN'000
Funds borrowed from the National Fund for Support of Entrepreneurship of the Republic of Azerbaijan	22,440	20,230
Funds borrowed from Azerbaijan Mortgage Fund	9,735	7,427
Funds borrowed from International Finance Corporation (IFC)	5,436	5,513
Funds borrowed from the State Agency for Agricultural Credits	5,385	6,616
Funds borrowed from World Business Capital Inc (WBC)	3,761	4,319
Funds borrowed from Black Sea Trade and Development Bank	3,301	-
Funds borrowed from Islamic Cooperation for Development of the Private Sector (ICDPS)	3,131	1,278
Funds borrowed from International Fund for Agricultural development (IFAD)	3,010	2,010
Other	-	21
	56,199	47,414

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 2012 the Group has AZN 22,440 thousand (31 December 2011: AZN 20,230 thousand) payable to the fund, repayable on 25 September 2014. The borrowing agreement does not include any financial covenants.

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 2012 the Group has AZN 9,735 thousand (31 December 2011: AZN 7,427 thousand) payable to the Fund. 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 2012, the outstanding amount of debt under this credit agreement was AZN 5,436 thousand (31 December 2011: AZN 5,513 thousand) at an interest rate of 6.06% per annum. The Group is obliged to comply with certain financial covenants stipulated by the aforementioned loan agreement.

On 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 2012 the Group has AZN 5,385 thousand (31 December 2011: AZN 6,616 thousand) payable to the Agency that is repayable from 2012 to 2014. The borrowing agreement does not include any financial covenants.

18 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 2012, the Group had drawn down credit in the amount of AZN 3,761 thousand (31 December 2011: AZN 4,319 thousand) at an interest rate of 3.8125% (3 month LIBOR plus 3.5%) per annum. The maturity date of the loan agreement is 25 June 2019. The Group is obliged to comply with certain financial covenants stipulated by the aforementioned loan agreement.

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

On 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 2012, the outstanding amount under both credit agreements was AZN 3,131 thousand (31 December 2011: AZN 1,278 thousand) that is repayable from 2013 to 2017. Interest is charged on ICDPS borrowings at 5 years USD Swap rate plus 700 basis points per annum with a floor of 9% and a cap of 12% per annum. The Group is obliged to comply with certain financial covenants stipulated by the aforementioned loan agreement.

On 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 2012, the Group had total borrowings of AZN 2,111 thousand and USD 1,126 thousand (31 December 2011: AZN 553 thousand and USD 1,853 thousand) from IFAD that is repayable from 2012 to 2014. Interest is charged on IFAD borrowings from 2-6% depending on the specific project for which the loan is made. The borrowing agreement does not include any financial covenants.

(a) Breach of covenants

As at 31 December 2012, the Group was not in compliance with the financial covenant set by IFC which was Single Currency Foreign Exchange Risk Ratio.

As at 31 December 2012, the Group was not in compliance with the financial covenant set by ICDPS which was the foreign currency open position to total tier 1 capital ratio. On 10 March 2013, ICDPS issued a letter waiving the Group's non-compliance with this ratio as at 31 December 2012.

As at 31 December 2012, the Group was in compliance with the financial covenants set by WBC. However, included in the loan agreement between the Group and WBC is a cross-default condition whereby failing to fulfil the covenants on other borrowings can result in default on the borrowing from WBC.

As a result of the breaches of the covenants mentioned above, amounts payable to IFC, ICDPS and WBC are repayable on demand. Accordingly as at 31 December 2012, the Group presented AZN 12,328 thousand in respect of these loans as repayable on demand in the liquidity analysis (note 23). By presenting these borrowings as repayable on demand, the ratio of liquid assets to liquid liabilities required by the covenants in the loan agreement with ICDPS was also breached. As of the date of these consolidated financial statements the Group requested waiver letters from above financial institutions. The management believes that loan principal and interest payments will be made in accordance with the standard contractual terms.

19 Other liabilities

	2012 AZN'000	2011 AZN'000
Amounts in course of settlement	122	101
Payables on securities settlements	5	5
Other financial liabilities	31	19
Total other financial liabilities	158	125
Provision for guarantees and letters of credit issued	148	105
Other non-financial liabilities	46	13
Total other non-financial liabilities	194	118
Total other liabilities	352	243

20 Share capital

(a) Issued capital and share premium

The authorised, issued and outstanding share capital comprises 27,727 ordinary shares (2011: 22,000). All shares have a nominal value of AZN 1,082 (2011: nominal value of AZN 1,000). During 2011, 2,000 shares were issued. Of these issued shares, 300 were paid for in cash with a total value of AZN 300 thousand and 1,700 were paid for through a transfer from retained earnings of AZN 1,700 thousand. During 2012, 5,727 ordinary shares were issued with a nominal value of AZN 1,082 per share. These 5,727 shares were paid for in cash with a total value of AZN 6,197 thousand. An increase in the nominal value of shares issued in prior years from AZN 1,000 to AZN 1,082 per share was settled through a transfer of AZN 1,804 thousand from retained earnings.

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.

On 25 July 2012, the Central Bank of the Azerbaijan Republic issued an order requiring to increase the minimum total capital of commercial banks to AZN 50 million by 1 January 2014. At the General Meeting of Shareholders of the Bank on 7 September 2012, the Bank decided to increase its share capital to AZN 50,000 thousand to be fully paid in 2013.

(b) Dividends

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 3,220 thousand as at 31 December 2012 (2011: AZN 3,305 thousand).

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

	2012 AZN	2011 AZN
Dividends per ordinary share (in AZN)	65	70
Other distributions per ordinary share (in AZN)	82	85

21 Earnings per share

(a) Basic earnings per share

The calculation of basic earnings per share as at 31 December 2012 is based on the profit attributable to ordinary shareholders of AZN 3,186 thousands (2011: AZN 3,156 thousands), and a weighted average number of ordinary shares outstanding of 23,015 (2011: 21,507) calculated as follows.

	2012 AZN'000	2011 AZN'000
Net profit attributable to ordinary shareholders (AZN'000)	3,186	3,156
Weighted average number of ordinary shares for the year ended 31 December	23,015	21,507
Basic and diluted earnings per share (AZN per share)	138	147
	2012 AZN'000	2011 AZN'000
Issued ordinary shares at the beginning of the year	22,000	20,000
Effect of shares issued during the year	1,015	1,507
Weighted average number of ordinary shares for the year ended 31 December	23,015	21,507

22 Analysis by segment

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 2012 (2011: one).

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

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

23 Risk management

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

(a) Risk management policies and procedures

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

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

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

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

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

(b) Market risk

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

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

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

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

23 Risk management, continued

(b) Market risk, continued

(i) Interest rate risk

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

Interest rate gap analysis

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

AZN '000	Less than 3 months	3-6 months	6-12 months	1-5 years	More than 5 years	Non- interest bearing	Carrying amount
31 December 2012							
ASSETS							
Cash and cash equivalents	-	-	-	-	-	36,305	36,305
Available-for-sale financial assets	-	-	-	202	337	1,110	1,649
Loans and advances to banks	3,436	330	-	507	-	2,942	7,215
Loans to customers	20,876	17,970	50,267	60,329	8,249	3,588	161,279
	24,312	18,300	50,267	61,038	8,586	43,945	206,448
LIABILITIES							
Deposits and balances from banks	4,151	5,960	-	14,962	-	458	25,531
Current accounts and deposits from customers	15,920	6,941	15,916	24,153	23	39,807	102,760
Other borrowed funds	12,833	1,487	7,820	25,445	8,380	234	56,199
	32,904	14,388	23,736	64,560	8,403	40,499	184,490
	(8,592)	3,912	26,531	(3,522)	183	3,446	21,958
31 December 2011							
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
	17,185	11,882	36,716	51,934	6,837	32,264	156,818
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
	14,373	8,992	19,294	51,174	7,624	39,982	141,439
	2,812	2,890	17,422	760	(787)	(7,718)	15,379

23 Risk management, continued

(b) Market risk, continued

(i) Interest rate risk, continued

Average interest rates

The table below displays average effective interest rates for interest bearing assets and liabilities as at 31 December 2012 and 2011. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

	2012			2011		
	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%	-
Available-for-sale financial assets	1.00%	-	-	2.70%	-	-
Loans and advances to banks	8.18%	8.33%	-	13.67%	7.56%	-
Loans to customers	13.19%	16.40%	7.96%	13.00%	18.90%	18.80%
Interest bearing liabilities						
Deposits and balances from banks						
- Vostro accounts	-	-	-	-	-	-
- Term deposits	6.52%	8.82%	4.39%	4.50%	8.00%	3.00%
Current accounts and deposits from customers						
- Current accounts and demand deposits	4.55%	3.32%	4.50%	5.08%	4.36%	5.00%
- Term deposits	11.72%	13.45%	12.28%	13.91%	13.88%	12.29%
Other borrowed funds	1.87%	7.16%	-	2.23%	5.12%	-

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 2012 and 2011 is as follows:

	2012	2011
	AZN'000	AZN'000
100 bp parallel fall	(64)	(109)
100 bp parallel rise	64	109

23 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 2012:

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

23 Risk management, continued

(b) Market risk, continued

(ii) Currency risk, continued

The following table shows the currency structure of financial assets and liabilities as at 31 December 2011:

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

A weakening of the AZN, as indicated below, against the following currencies at 31 December 2012 and 2011 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.

	2012 AZN'000	2011 AZN'000
10% appreciation of USD against AZN	(458)	(942)
10% appreciation of EUR against AZN	(48)	21

A strengthening of the AZN against the above currencies at 31 December 2012 and 2011 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.

23 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 through the use of scoring models and application data verification procedures developed together with the Risk Department.

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

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

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

	2012	2011
	AZN'000	AZN'000
ASSETS		
Cash and cash equivalents	13,569	13,105
Available-for-sale financial assets	539	7,292
Loans and advances to banks	4,412	2,276
Loans to customers	161,279	116,997
Other financial assets	106	35
Total maximum exposure	179,905	139,705

23 Risk management, continued

(c) Credit risk, continued

The Group holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired.

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

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

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

As at 31 December 2012 the Group has no debtors or groups of connected debtors (2011: none) credit risk exposure to whom exceeds 10% of maximum credit risk exposure.

(d) Liquidity risk

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

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

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.

23 Risk management, continued

(d) Liquidity risk, continued

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.

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 inflow and 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 financial liabilities as at 31 December 2012 is as follows:

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

The maturity analysis for 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

23 Risk management, continued

(d) Liquidity risk, continued

In accordance with Azerbaijani legislation, individuals and legal entities can withdraw their term deposits at any time, 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.

23 Risk management, continued

(d) Liquidity risk, continued

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

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

23 Risk management, continued

(d) Liquidity risk, continued

The table below shows an analysis, by expected maturities, of the amounts recognised in the statement of financial position as at 31 December 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 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 (2011: 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 2012, this minimum level is 12% (31 December 2011: 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 2012 and 2011.

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

	2012 AZN'000	2011 AZN'000
Primary capital	33,824	24,600
Total capital	33,824	24,600
Risk-weighted assets	189,104	149,214
Capital adequacy ratio (%)	17.89%	16.49%

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.

24 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:

	2012 AZN'000	2011 AZN'000
	<u> </u>	<u> </u>
Tier 1 capital		
Share capital	30,001	22,000
Retained earnings	1,182	1,178
Less: Intangible assets	(96)	(68)
Total tier 1 capital	<u>31,087</u>	<u>23,110</u>
Tier 2 capital		
Reserves	2,492	1,865
Asset revaluation reserve	667	710
Revaluation reserve for available-for sale assets	20	-
Total tier 2 capital	<u>3,179</u>	<u>2,575</u>
Less: Investments	(1,110)	(1,085)
Total capital	<u><u>33,156</u></u>	<u><u>24,600</u></u>
Risk-weighted assets		
On-balance sheet	183,380	134,984
Off-balance sheet	15,962	14,230
Total risk weighted assets	<u>199,342</u>	<u>149,214</u>
Total capital expressed as a percentage of risk-weighted assets (total capital ratio)	<u>16.63%</u>	<u>16.49%</u>
Total tier 1 capital expressed as a percentage of risk-weighted assets (tier 1 capital ratio)	<u>15.59%</u>	<u>15.49%</u>

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

The Group is subject to minimum capital adequacy requirements calculated in accordance with the Basle Accord established by covenants under liabilities incurred by the Group. The Group has complied with all externally imposed capital requirements during the years ended 31 December 2012 and 2011.

25 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.

	2012 AZN'000	2011 AZN'000
Contracted amount		
Loan and credit line commitments	9,010	9,605
Guarantees and letters of credit	17,602	4,452
	26,612	14,057

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.

26 Operating leases

(a) Leases as lessee

The Group leases a number of premises and equipment under operating leases. The leases typically run for an initial period of five to ten years, with an option to renew the lease after that date. Lease payments are usually increased annually to reflect market rentals. None of the leases includes contingent rentals.

27 Contingencies

(a) Insurance

The insurance industry in the Republic of Azerbaijan is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Group has some coverage for its premises and equipment, business interruption, or third party liability in respect of property or environmental damage arising from accidents on its property or relating to operations. 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, penalties 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 Azerbaijan that are substantially more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Azerbaijan tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on the financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

28 Related party transactions

(a) Control relationships

The Bank does not have an ultimate controlling party.

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

Total remuneration included in personnel expenses for the years ended 31 December 2012 and 2011 is as follows:

	2012 AZN'000	2011 AZN'000
Short term employee benefits	379	314
	379	314

28 Related party transactions, continued

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

The outstanding balances and average interest rates as at 31 December 2012 and 2011 for transactions with the members of the Supervisory Board and the Management Board are as follows:

	2012 AZN'000	Average interest rate, %	2011 AZN'000	Average interest rate, %
Consolidated statement of financial position				
Loans issued (gross)	195	7.0%	144	6.0%
Loan impairment allowance	-		(3)	
Current accounts and deposits received	1,166	0.5 %	1,224	0.5%

The loans are in Azerbaijani Manats and repayable by 2015.

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

	2012 AZN'000	2011 AZN'000
Profit or loss		
Interest income	10	8
Interest expense	4	5

28 Related party transactions, continued

(d) Transactions with other shareholders

In addition to its related party disclosures, the Bank disclosed outstanding balances and the related average interest rates as at 31 December 2012 and 2011 and related profit or loss amounts of transactions for the year ended 31 December 2012 and 2011 with other shareholders (holding 5% or more of shares of the Bank):

	2012		2011	
	2012 AZN'000	Average interest rate, %	2011 AZN'000	Average interest rate, %
Consolidated statement of financial position				
ASSETS				
Loans to customers				
- In AZN:				
Principal balance	2	12%	206	15%
Impairment allowance	-		(5)	
- In USD:				
Principal balance	-	-	10	26%
LIABILITIES				
Current accounts and deposits from customers	1,150	13%	1,006	14%
Profit (loss)				
Interest income	1		36	
Interest expense	(13)		(76)	
Fee and commission income	1		2	
Impairment losses	-		(5)	
Other general and administrative expenses	-		(62)	

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

29 Financial assets and liabilities: fair values and accounting classifications

(a) Accounting classifications and fair values

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

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

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 customers:					
Loans to legal entities	54,548	-	-	54,547	58,684
Loans to retail customers	62,449	-	-	62,450	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
	-	-	141,564	141,564	143,914

The Management of the Group believes that nominal amounts of the funds borrowed from government institutions represent their fair values, as these instruments represent a separate market segment which is specific to the Azerbaijani market.

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

(a) Accounting classifications and fair values, continued

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

- discount rates of 13.22%-13.32% and 18.25%-22.06% are used for discounting future cash flows from loans to corporate customers and loans to retail customers, respectively
- discount rates of 3.69% - 6.95% and 10.25% – 10.75% are used for discounting future cash flows from current accounts and deposits of corporate and retail customers, respectively
- quoted market prices are used for determination of fair value of available for sale financial assets.

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 2012, 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	539
	539

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

(b) Fair value hierarchy, continued

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
	7,292