NIKOIL OPEN JOINT STOCK COMPANY INVESTMENT COMMERCIAL BANK

Financial Statements
For the Year Ended December 31, 2013

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NIKOIL OPEN JOINT STOCK COMPANY INVESTMENT COMMERCIAL BANK

STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2013

Management is responsible for the preparation of the financial statements that present fairly the financial position of Nikoil Open Joint Stock Company Investment Commercial Bank ("the Bank") as at December 31, 2013, and the results of its operations, cash flows and changes in equity for the year then ended, in compliance with International Financial Reporting Standards ("IFRS").

In preparing the financial statements, management is responsible for:

- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Bank's financial position and financial performance;
- Making an assessment of the Bank's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Bank;
- Maintaining adequate accounting records that are sufficient to show and explain the Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Bank, and which enable them to ensure that the financial statements of the Bank comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Bank; and
- Preventing and detecting fraud and other irregularities.

The financial statements of the Bank for the year ended December 31, 2013 were approved by Management on May 30, 2014.

On behalf of the Management Board:

Mr. Vasiliy Khamaza Chairman of the Management Board	Ms. Elmira Aleskerova Financial Director
May 30, 2014 *Baku, the Republic of Azerbaijan*	*May 30, 2014* *Baku, the Republic of Azerbaijan*

"Deloitte & Touche LLC"
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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Management Board of Nikoil Open Joint Stock Company Investment Commercial Bank:

We have audited the accompanying financial statements of Nikoil Open Joint Stock Company Investment Commercial Bank ("the Bank"), which comprise the statement of financial position as at December 31, 2013, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these 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 financial statements are free from material misstatement.

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

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

Opinion

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

Other Matter

The financial statements of the Bank for the year ended December 31, 2012 were audited by another auditor who expressed an unqualified opinion on those statements on April 16, 2013.

Deloitte & Touche.

May 30, 2014
Baku, the Republic of Azerbaijan

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STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2013
(in thousands of Azerbaijan Manats)

	Notes	December 31, 2013	December 31, 2012
ASSETS:			
Cash and balances with the Central Bank of the Republic of Azerbaijan	5	10,745	10,581
Due from banks	6	14,234	4,470
Loans to customers	7, 28	224,256	178,752
Available-for-sale investments		304	304
Deferred income tax assets	22	1,100	1,306
Property and equipment	8	8,246	6,085
Intangible assets	9	1,534	1,170
Current income tax asset		507	-
Other assets	10	1,906	343
Repossessed assets	11	3,365	2,014
TOTAL ASSETS		**266,197**	**205,025**
LIABILITIES:			
Due to banks and other financial institutions	12, 28	36,965	40,840
Customer accounts	13, 28	172,670	131,995
Other liabilities	14	432	1,335
Income tax payable		-	108
Subordinated debt	15, 28	11,897	-
TOTAL LIABILITIES		**221,964**	**174,278**
EQUITY:			
Share capital	16	34,500	22,500
Share premium		401	401
Retained earnings		9,332	7,846
TOTAL EQUITY		**44,233**	**30,747**
TOTAL LIABILITIES AND EQUITY		**266,197**	**205,025**

On behalf of the Management Board:

Azərbaycan Respublikası Azerbaijan Republic Азербайджанская Республика NIKOIL ASC NIKOYL OAO

Mr. Vasiliy Khamaza
Chairman of the Management Board

May 30, 2014
Baku, the Republic of Azerbaijan

Ms. Elmira Aleskerova
Financial Director

May 30, 2014
Baku, the Republic of Azerbaijan

The notes on pages 8-49 form an integral part of these financial statements.

NIKOIL OPEN JOINT STOCK COMPANY INVESTMENT COMMERCIAL BANK

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHESIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 2013
(in thousands of Azerbaijan Manats except for earnings per share which are in AZN)

	Notes	Year ended December 31, 2013	Year ended December 31, 2012
Interest income	17, 28	32,766	33,269
Interest expense	17, 28	(16,980)	(15,108)
Net interest income before recovery of provision/(provision) on interest bearing assets		15,786	18,161
Recovery of provision/(provision) on interest bearing assets	18, 28	82	(3,305)
Net interest income		**15,868**	**14,856**
Net gain on foreign exchange operations	19	517	488
Fee and commission income	20	2,979	3,330
Fee and commission expense	20	(271)	(363)
Recovery of provision/(provision) for impairment losses on other assets and transactions	18	216	(319)
Other income		10	16
Net non-interest income		**3,451**	**3,152**
Operating income		**19,319**	**18,008**
Operating expenses	21, 28	(17,087)	(14,594)
Profit before income tax		**2,232**	**3,414**
Income tax expense	22	(746)	(974)
Net profit for the year		**1,486**	**2,440**
Other comprehensive income		-	-
Total comprehensive income for the year		**1,486**	**2,440**
EARNINGS PER SHARE Basic and diluted (AZN)	23	0.09	0.22

On behalf of the Management Board:

Mr. Vasiliy Khamaza
Chairman of the Management Board

May 30, 2014
Baku, the Republic of Azerbaijan

Ms. Elmira Aleskerova
Financial Director

May 30, 2014
Baku, the Republic of Azerbaijan

The notes on pages 8-49 form an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2013
(in thousands of Azerbaijan Manats)

	Note	Share capital	Share premium	Retained earnings	Total equity
December 31, 2011		**22,500**	**401**	**5,406**	**28,307**
Profit for the year		-	-	2,440	2,440
December 31, 2012		**22,500**	**401**	**7,846**	**30,747**
Issue of ordinary shares	16	12,000	-	-	12,000
Profit for the year		-	-	1,486	1,486
December 31, 2013		**34,500**	**401**	**9,332**	**44,233**

On behalf of the Management Board:

Mr. Vasiliy Khamaza
Chairman of the Management Board

May 30, 2014
Baku, the Republic of Azerbaijan

Ms. Elmira Aleskerova
Financial Director

May 30, 2014
Baku, the Republic of Azerbaijan

The notes on pages 8-49 form an integral part of these financial statements.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2013
(in thousands of Azerbaijan Manats)

	Notes	Year ended December 31, 2013	Year ended December 31, 2012
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit for the year before income tax		2,232	3,414
Adjustments for:			
(Recovery of provision)/provision for impairment losses on interest bearing assets	18	(82)	3,305
(Recovery of provision)/provision for impairment losses on other assets and transactions		(216)	319
Depreciation and amortization	21	1,473	993
Translation loss on foreign exchange operations	19	21	37
Net change in interest accruals		(3,095)	(4,834)
Cash inflow from operating activities before changes in operating assets and liabilities		333	3,234
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Mandatory reserve deposit and other blocked accounts with the CBAR		396	(1,704)
Due from banks		(3,915)	(561)
Loans to customers		(43,123)	(35,598)
Other assets		(1,563)	106
Increase/(decrease) in operating liabilities			
Due to banks and other financial institutions		(3,812)	19,232
Customer accounts		40,073	7,713
Other liabilities		(648)	148
Cash outflow from operating activities before taxation		(12,259)	(7,430)
Income tax paid		(1,155)	(1,297)
Net cash outflow from operating activities		(13,414)	(8,727)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Payments for property, equipment and intangible assets	8, 9, 10	(4,027)	(2,167)
Payments for available-for-sale investments		-	(304)
Net cash outflow from investing activities		(4,027)	(2,471)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issue of ordinary shares	16	12,000	-
Proceeds from subordinated debt	15	11,768	-
Net cash inflow from financing activities		23,768	-

STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED DECEMBER 31, 2013
(in thousands of Azerbaijan Manats)

	Notes	Year ended December 31, 2013	Year ended December 31, 2012
Effect of exchange rate changes on the balance of cash held in foreign currencies		(1)	18
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		6,326	(11,180)
CASH AND CASH EQUIVALENTS, beginning of the year	5	10,615	21,795
CASH AND CASH EQUIVALENTS, end of the year	5	16,941	10,615

Interest paid and received by the Bank during the year ended December 31, 2013 amounted to AZN 16,249 thousand and AZN 29,003 thousand, respectively.

Interest paid and received by the Bank during the year ended December 31, 2012 amounted to AZN 14,533 thousand and AZN 27,857 thousand, respectively.

On behalf of the Management Board:

Mr. Vasiliy Khamaza
Chairman of the Management Board

May 30, 2014
Baku, the Republic of Azerbaijan

Ms. Elmira Aleskerova
Financial Director

May 30, 2014
Baku, the Republic of Azerbaijan

The notes on pages 8-49 form an integral part of these financial statements.

1. ORGANIZATION

"Nikoil" Open Joint Stock Company Investment Commercial Bank (the "Bank") was incorporated and is domiciled in the Republic of Azerbaijan. The Bank is an open joint stock company and was set up in accordance with regulations of the Republic of Azerbaijan. The Bank's principal business activities are commercial and retail banking operations within the Republic of Azerbaijan. As at December 31, 2013 and 2012 the Bank had 17 and 15 branches, respectively, operating in the Republic of Azerbaijan.

Originally, "Ulpar" JSCB was founded in 1994 in the Republic of Azerbaijan and held general banking license No 203 issued in 1994. During 2002, "Nikoil" Closed Joint Stock Company and "Lukoil Azerbaijan" Closed Joint Stock Company acquired the controlling interest in the Bank and the Bank was renamed to "Nikoil" OJSC Investment Commercial Bank. The Bank has started operations under a full banking license No 203 issued by the Central Bank of the Republic of Azerbaijan ("CBAR") since May 2, 2002. On July 2, 2008, "Topaz Investments" LLC has acquired the controlling interest in the Bank.

The registered office of the Bank is located at 30, Pushkin Street, Baku AZ1010, Azerbaijan.

As at December 31, 2013 and 2012, the following shareholders owned the issued share capital of the Bank:

Shareholder	December 31, 2013, %	December 31, 2012, %
"Topaz Investments Limited" LLC	56.4	56.4
"Nikoil" CJSIC	33.6	28.7
"UralSib" Invest LLP	9.0	13.9
"ISR Holding" LLC	1.0	1.0
Total	**100.0**	**100.0**

Refer to Note 16 for the ultimate controlling party of the Bank.

These financial statements were authorized for issue on May 30, 2014 by the Management Board.

2. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance. These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

These financial statements have been prepared assuming that the Bank is a going concern and will continue operation for the foreseeable future.

These financial statements are presented in thousands Azerbaijan Manats ("AZN"), unless otherwise indicated.

These financial statements have been prepared on the historical cost basis.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Bank takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date.

Fair value for measurement and/or disclosure purposes in these financial statements is determined on such a basis, except for leasing transactions that are within the scope of IAS 17, and measurements that have some similarities to fair value but are not fair value, such as value in use in IAS 36.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

The Bank is registered in the Republic of Azerbaijan and maintains its accounting records in accordance with local accounting pracitices. These financial statements have been prepared from the statutory accounting records and have been adjusted to conform to IFRS.

The Bank presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the statement of financial position date (current) and more than 12 months after the statement of financial position date (non-current) is presented (see Note 27).

Functional currency. Items included in the financial statements of Bank are measured using the currency of the primary economic environment in which the entity operates (“the functional currency”). The functional currency of the Bank is the AZN. The presentational currency of the financial statements of the Bank is the AZN. All values are rounded to the nearest thousand AZN, except when otherwise indicated.

Offsetting. Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expense is not offset in the statement of profit or loss and other comprehensive income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Bank.

The principal accounting policies are set out below.

Revenue recognition

Recognition of interest income and expense. Interest income from a financial asset is recognized when it is probable that the economic benefits will flow to the Bank and the amount of income can be measured reliably. Interest income and expense are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Once a financial asset or a group of similar financial assets has been written down (partly written down) as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest earned on assets at fair value is classified within interest income.

Recognition of fee and commission income. Loan origination fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the loan. Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in profit or loss over the remaining period of the loan commitment. Where a loan commitment expires without resulting in a loan, the loan commitment fee is recognized in profit or loss on expiry. Loan servicing fees are recognized as revenue as the services are provided. All other commissions are recognized when services are provided.

Financial instruments. The Bank recognizes financial assets and liabilities in its statement of financial position when it becomes a party to the contractual obligations of the instrument. Regular way purchases and sales of financial assets and liabilities are recognized using settlement date accounting. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

Financial assets. Financial assets are classified into the following specified categories: ‘available-for-sale’ (“AFS”) financial assets and ‘loans and receivables’. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Available-for-sale financial assets. Available-for-sale financial assets are non-derivatives that are either designated as available-for-sale or are not classified as (a) loans and receivables, (2) held to maturity investments or (c) financial assets at fair value through profit or loss.

The fair value of AFS monetary assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the end of the reporting period. The foreign exchange gains and losses that are recognised in profit or loss are determined based on the amortised cost of the monetary asset. Other foreign exchange gains and losses are recognised in other comprehensive income.

AFS equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less any identified impairment losses at the end of each reporting period.

Loans and receivables. Loans, and other receivables that have fixed or determinable payments that are not quoted in an active market (including balances with the Central Bank of the Republic of Azerbaijan, due from banks, loans to customers and other financial assets) are classified as ‘loans and receivables’. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Impairment of financial assets. Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For unlisted equity investments classified as AFS, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

For all other financial assets, objective evidence of impairment could include:

- Significant financial difficulty of the issuer or counterparty; or
- Breach of contract, such as default or delinquency in interest or principal payments; or
- It becoming probable that the borrower will enter bankruptcy or financial re-organisation; or
- Disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial asset, such as loans and receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of loans and receivables could include the Bank's past experience of collecting payments, an increase in the number of delayed payments in the portfolio, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortised cost, the amount of the impairment loss recognised is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

For financial assets carried at cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment loss will not be reversed in subsequent periods.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of loans and receivables, where the carrying amount is reduced through the use of an allowance account. When a loan or a receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognised in other comprehensive income are reclassified to profit or loss in the period.

For financial assets measured at amortized cost, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

In respect of AFS equity securities, impairment losses previously recognized in profit or loss are not reversed through profit or loss. Any increase in fair value subsequent to an impairment loss is recognized in other comprehensive income and accumulated under the heading of available-for-sale revaluation reserve.

In respect of AFS debt securities, impairment losses are subsequently reversed through profit or loss if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

Renegotiated loans. Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

Write off of loans and advances. Loans and advances are written off against the allowance for impairment losses when deemed uncollectible. Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Bank and after the Bank has sold all available collateral. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in the statement of profit or loss and other comprehensive income in the period of recovery. In accordance with the statutory legislation, loans may only be written off with the approval of the Supervisory Board and, in certain cases, with the respective decision of the Court.

Derecognition of financial assets. The Bank derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another party. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit or loss.

On derecognition of a financial asset other than in its entirety (e.g. when the Bank retains an option to repurchase part of a transferred asset), the Bank allocates the previous carrying amount of the financial asset between the part it continues to recognize under continuing involvement, and the part it no longer recognises on the basis of the relative fair values of those parts on the date of the transfer. The difference between the carrying amount allocated to the part that is no longer recognised and the sum of the consideration received for the part no longer recognised and any cumulative gain or loss allocated to it that had been recognised in other comprehensive income is recognized in profit or loss. A cumulative gain or loss that had been recognised in other comprehensive income is allocated between the part that continues to be recognised and the part that is no longer recognised on the basis of the relative fair values of those parts.

Financial liabilities and equity instruments issued

<u>Classification as debt or equity.</u> Debt and equity instruments issued by an entity are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

<u>Equity instruments.</u> An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Bank are recognised at the proceeds received, net of direct issue costs.

Repurchase of the Bank's own equity instruments is recognized and deducted directly in equity. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Bank's own equity instruments.

Other financial liabilities. Other financial liabilities (including deposits by banks and customers, loans received from government agencies and other financial liabilities) are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Financial guarantee contracts. A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance with the terms of a debt instrument.

Financial guarantee contracts issued by the Bank are initially measured at their fair values and, if not designated as at FVTPL, are subsequently measured at the higher of:

- The amount of the obligation under the contract, as determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
- The amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with the revenue recognition policies.

Derecognition of financial liabilities. The Bank derecognises financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or they expire. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit and loss.

Leases. Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Bank as lessee. Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

Cash and cash equivalents. Cash and cash equivalents consist of cash on hand, unrestricted balances on correspondent and term deposits with the CBAR with original maturity of less or equal to 90 days and amounts due from credit institutions with original maturity of less or equal to 90 days and are free from contractual encumbrances.

Mandatory cash balances with the CBAR. Mandatory cash balances with the CBAR represent mandatory reserve deposits with the CBAR, which are not available to finance the Bank's day-to-day operations and hence are not considered as part of cash and cash equivalents for the purposes of the statement of cash flows.

Repossessed assets. In certain circumstances, assets are repossessed following the foreclosure on loans that are in default. Repossessed assets are measured at the lower of carrying amount and fair value less costs to sell.

Property and equipment. Property and equipement are stated at cost less accumulated depreciation and accumulated impairment losses.

Depreciation is recognised so as to write off the cost of assets less their residual values over their useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following annual rates:

Buildings	5%
Furniture and equipment	20%
Computer equipments	25%
Other fixed assets	20%
Vehicles	25%
Leasehold improvements	10%
Intangible assets	10%

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

Intangible assets

Intangible assets acquired separately. Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised on a straight-line basis over their estimated useful lives. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Derecognition of intangible assets. An intangible asset is derecognised on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognised in profit or loss when the asset is derecognised.

Impairment of tangible and intangible assets. At the end of each reporting period, the Bank reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). When it is not possible to estimate the recoverable amount of an individual asset, the Bank estimates the recoverable amount of the cash-generating unit to which the asset belongs. When a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of 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 which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

When an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

Taxation. Income tax expense represents the sum of the tax currently payable and deferred tax.

Current tax. The tax currently payable is based on taxable profit for the year. Taxable profit before tax as reported in the statement of profit or loss and other comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Bank's current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax. Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax liabilities and assets are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

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

Current and deferred tax for the year. Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively.

Operating taxes. Azerbaijan also has various other taxes, which are assessed on the Bank’s activities. These taxes are included as a component of operating expenses in the statement of profit or loss and other comprehensive income.

Provisions. Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event, it is probable that the Bank will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (when the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

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

Foreign currencies. In preparing the financial statements, transactions in currencies other than the Bank's functional currency (foreign currencies) are recognised at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Exchange differences on monetary items are recognised in profit or loss in the period in which they arise.

The exchange rates used by the Bank in the preparation of the financial statements as at year-end are as follows:

	December 31, 2013	**December 31, 2012**
AZN/1 US Dollar	0.7845	0.7850
AZN/1 Euro	1.0780	1.0377

Collateral. The Bank obtains collateral in respect of customer liabilities where this is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the Bank a claim on these assets for both existing and future customer liabilities.

3. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION OF UNCERTAINTY

In the application of the Bank's accounting policies the Bank management is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Key sources of estimation uncertainty. The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Impairment of loans and receivables.The Bank regularly reviews its loans and receivables to assess for impairment. The Bank's loan impairment provisions are established to recognize incurred impairment losses in its portfolio of loans and receivables. The Bank considers accounting estimates related to allowance for impairment of loans and receivables a key source of estimation uncertainty because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and receivables are based on recent performance experience, and (ii) any significant difference between the Bank's estimated losses and actual losses would require the Bank to record provisions which could have a material impact on its financial statements in future periods.

The Bank uses management's judgment to estimate the amount of any impairment loss in cases where a borrower has financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on past performance, past customer behavior, observable data indicating an adverse change in the payment status of borrowers in a group, and national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans. The Bank uses management's judgment to adjust observable data for a group of loans to reflect current circumstances not reflected in historical data.

The allowances for impairment of financial assets in the financial statements have been determined on the basis of existing economic and political conditions. The Bank is not in a position to predict what changes in conditions will take place in the Republic of Azerbaijan and what effect such changes might have on the adequacy of the allowances for impairment of financial assets in future periods.

As at December 31, 2013 and 2012, gross loans and receivables totalled AZN 247,735 thousand and AZN 206,163 thousand, respectively, and the allowance for impairment losses amounted to AZN 23,479 thousand and AZN 27,411 thousand, respectively.

Valuation of financial instruments. As described in Note 25, the Bank uses valuation techniques that include inputs that are not based on observable market data to estimate the fair value of certain types of financial instruments. Note 25 provides detailed information about the key assumptions used in the determination of the fair value of financial instruments, as well as the detailed sensitivity analysis for these assumptions. The Bank management believes that the chosen valuation techniques and assumptions used are appropriate in determining the fair value of financial instruments.

Useful lives of property and equipment. As described above, the Bank reviews the estimated useful lives of property and equipment at the end of each annual reporting period.

Recoverability of deferred tax assets. The management of the Bank is confident that no valuation allowance against deferred tax assets at the reporting date is considered necessary, because it is more likely than the deferred tax asset will be fully realized. The carrying value of deferred tax assets amounted to AZN 1,100 thousand and AZN 1,306 thousand as at December 31, 2013 and 2012, respectively.

Tax legislation. Azerbaijani tax, currency and customs legislation is subject to varying interpretations. Refer to Note 24.

Initial recognition of related party transactions. In the normal course of business the Bank enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis. The management concluded that interest rates for transactions with related parties do not significantly differ from those applied to transactions with third parties. The information on related party balances is disclosed in Note 28.

4. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRSs)

The Bank has adopted the following new or revised standards and interpretations issued by International Accounting Standards Board and the International Financial Reporting Interpretations Committee (the IFRIC) which became effective for the Bank's annual financial statement for the year ended December 31, 2013:

Standards affecting the financial statements

New and revised Standards on consolidation, joint arrangements, associates and disclosures

In May 2011, a package of five standards on consolidation, joint arrangements, associates and disclosures was issued comprising IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities, IAS 27 (as revised in 2011) Separate Financial Statements and IAS 28 (as revised in 2011) Investments in Associates and Joint Ventures. Subsequent to the issue of these standards, amendments to IFRS 10, IFRS 11 and IFRS 12 were issued to clarify certain transitional guidance on the first-time application of the standards.

The impact of the application of these standards is set out below.

Impact of the application of IFRS 10. IFRS 10 replaces the parts of IAS 27 Consolidated and Separate Financial Statements that deal with consolidated financial statements and SIC-12 Consolidation – Special Purpose Entities. IFRS 10 changes the definition of control such that an investor has control over an investee when a) it has power over the investee, b) it is exposed, or has rights, to variable returns from its involvement with the investee and c) has the ability to use its power to affect its returns. All three of these criteria must be met for an investor to have control over an investee. Previously, control was defined as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Additional guidance has been included in IFRS 10 to explain when an investor has control over an investee. Some guidance included in IFRS 10 that deals with whether or not an investor that owns less than 50% of the voting rights in an investee has control over the investee is relevant to the Group.

Impact of the application of IFRS 11. IFRS 11 replaces IAS 31 *Interests in Joint Ventures*, and the guidance contained in a related interpretation, SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*, has been incorporated in IAS 28 (as revised in 2011). IFRS 11 deals with how a joint arrangement of which two or more parties have joint control should be classified and accounted for. Under IFRS 11, there are only two types of joint arrangements – joint operations and joint ventures. The classification of joint arrangements under IFRS 11 is determined based on the rights and obligations of parties to the joint arrangements by considering the structure, the legal form of the arrangements, the contractual terms agreed by the parties to the arrangement, and, when relevant, other facts and circumstances. A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement (i.e. joint operators) have rights to the assets, and obligations for the liabilities, relating to the arrangement. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement (i.e. joint venturers) have rights to the net assets of the arrangement. Previously, IAS 31 contemplated three types of joint arrangements – jointly controlled entities, jointly controlled operations and jointly controlled assets. The classification of joint arrangements under IAS 31 was primarily determined based on the legal form of the arrangement (e.g. a joint arrangement that was established through a separate entity was accounted for as a jointly controlled entity).

The initial and subsequent accounting of joint ventures and joint operations is different. Investments in joint ventures are accounted for using the equity method (proportionate consolidation is no longer allowed). Investments in joint operations are accounted for such that each joint operator recognises its assets (including its share of any assets jointly held), its liabilities (including its share of any liabilities incurred jointly), its revenue (including its share of revenue from the sale of the output by the joint operation) and its expenses (including its share of any expenses incurred jointly). Each joint operator accounts for the assets and liabilities, as well as revenues and expenses, relating to its interest in the joint operation in accordance with the applicable Standards.

Impact of the application of IFRS 12. IFRS 12 is a new disclosure standard and is applicable to entities that have interests in subsidiaries, joint arrangements, associates and/or unconsolidated structured entities. In general, the application of IFRS 12 has not resulted in additional disclosures in the financial statements.

Amendments to IFRS 7 *Financial instruments: Disclosures.* The Bank has applied the amendments to IFRS 7 titled *Disclosures – Transfers of Financial Assets* in the current year. The amendments increase the disclosure requirements for transactions involving the transfer of financial assets in order to provide greater transparency around risk exposures when financial assets are transferred.

Amendments to IAS 1 *Presentation of financial statements (amended June 2011).* The Bank has applied the amendments to IAS 1 titled *Presentation of Items of Other Comprehensive Income* in advance of the effective date (annual periods beginning on or after 1 July 2012). The amendment increases the required level of disclosure within the statement of comprehensive income.

The impact of this amendment has been to analyse items within the statement of comprehensive income between items that will not be reclassified subsequently to profit or loss and items that will be reclassified subsequently to profit or loss in accordance with the respective IFRS standard to which the item relates. The financial statements have also been amended to analyse income tax on the same basis. The amendments have been applied retrospectively, and hence the presentation of items of comprehensive income have been restated to reflect the change. Other than the above mentioned presentation changes, the application of the amendments to IAS 1 do not result in any impact on profit or loss, comprehensive income and total comprehensive income.

IFRS 13 *Fair Value Measurement*. The Bank has applied IFRS 13 for the first time in the current year. IFRS 13 establishes a single source of guidance for fair value measurements and disclosures about fair value measurements. The scope of IFRS 13 is broad; the fair value measurement requirements of IFRS 13 apply to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements, except for share-based payment transactions that are within the scope of IFRS 2 *Share-based Payment*, leasing transactions that are within the scope of IAS 17 *Leases, and measurements* that have some similarities to fair value but are not fair value (e.g. net realisable value for the purposes of measuring inventories or value in use for impairment assessment purposes).

IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions. Fair value under IFRS 13 is an exit price regardless of whether that price is directly observable or estimated using another valuation technique. Also, IFRS 13 includes extensive disclosure requirements.

IFRS 13 requires prospective application from 1 January 2013. In addition, specific transitional provisions were given to entities such that they need not apply the disclosure requirements set out in the Standard in comparative information provided for periods before the initial application of the Standard. In accordance with these transitional provisions, the Bank has not made any new disclosures required by IFRS 13 for the 2012 comparative period. Other than the additional disclosures, the application of IFRS 13 has not had any material impact on the amounts recognised in the financial statements.

Amendments to IAS 1 *Presentation of Financial Statements* (as part of the Annual Improvements to IFRSs 2009 - 2011 Cycle issued in May 2012).

The Annual Improvements to IFRSs 2009 - 2011 have made a number of amendments to IFRSs. The amendments that are relevant to the Bank are the amendments to IAS 1 regarding when a statement of financial position as at the beginning of the preceding period (third statement of financial position) and the related notes are required to be presented. The amendments specify that a third statement of financial position is required when a) an entity applies an accounting policy retrospectively, or makes a retrospective restatement or reclassification of items in its financial statements, and b) the retrospective application, restatement or reclassification has a material effect on the information in the third statement of financial position. The amendments specify that related notes are not required to accompany the third statement of financial position.

New and revised IFRSs in issue but not yet effective

The Bank has not applied the following new and revised IFRSs that have been issued but are not yet effective:

IFRS 9 *Financial Instruments*
Amendments to IFRS 9 and IFRS 7 *Mandatory Effective Date of IFRS 9 and Transition Disclosures*[2]
Amendments to IFRS 10, IFRS 12 and IAS 27 *Investment Entities*[1]

Amendments to IAS 32 *Offsetting Financial Assets and Financial Liabilities*[1]
Amendments to IAS 36 *Impairment of Assets*[1]
Amendments to IAS 39 *Financial Instruments: Recognition and Measurement*[1]
Amendments to IFRIC 21 *Levies*[1]

[1] Effective for annual periods beginning on or after 1 January 2014, with earlier application permitted. Disclose effect of changes if expected.
[2] Effective for annual periods beginning on or after 1 January 2015, with earlier application permitted. Disclose effect of changes if expected.

IFRS 9 *Financial Instruments.* IFRS 9, issued in November 2009, introduced new requirements for the classification and measurement of financial assets. IFRS 9 was amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition.

Key requirements of IFRS 9:

- All recognised financial assets that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* are required to be subsequently measured at amortised cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair value at the end of subsequent accounting periods. In addition, under IFRS 9, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income, with only dividend income generally recognised in profit or loss.

- With regard to the measurement of financial liabilities designated as at fair value through profit or loss, IFRS 9 requires that the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Under IAS 39, the entire amount of the change in the fair value of the financial liability designated as fair value through profit or loss is presented in profit or loss.

The management of the Bank anticipate that the application of IFRS 9 in the future may have a significant impact on amounts reported in respect of the Bank's financial assets and financial liabilities (e.g. the Bank's investments in redeemable notes that are currently classified as available-for-sale financial assets will have to be measured at fair value at the end of subsequent reporting periods, with changes in the fair value being recognised in profit or loss). However, it is not practicable to provide a reasonable estimate of the effect of IFRS 9 until a detailed review has been completed.

Amendments to IFRS 10, IFRS 12 and IAS 27 Investment Entities. The amendments to IFRS 10 define an investment entity and require a reporting entity that meets the definition of an investment entity not to consolidate its subsidiaries but instead to measure its subsidiaries at fair value through profit or loss in its financial statements.

To qualify as an investment entity, a reporting entity is required to:

- obtain funds from one or more investors for the purpose of providing them with professional investment management services;
- commit to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
- measure and evaluate performance of substantially all of its investments on a fair value basis.

Consequential amendments have been made to IFRS 12 and IAS 27 to introduce new disclosure requirements for investment entities.

The management of the Bank do not anticipate that the investment entities amendments will have any effect on the Bank's financial statements as the Bank is not an investment entity.

Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities. The amendments to IAS 32 clarify the requirements relating to the offset of financial assets and financial liabilities. Specifically, the amendments clarify the meaning of ‘currently has a legally enforceable right of set-off’ and ‘simultaneous realisation and settlement’.

The management of the Bank do not anticipate that the application of these amendments to IAS 32 will have a significant impact on the Bank's financial statements as the Bank does not have any financial assets and financial liabilities that qualify for offset.

5. CASH AND BALANCES WITH CENTRAL BANK OF THE REPUBLIC OF AZERBAIJAN

	December 31, 2013	December 31, 2012
Cash on hand	6,633	4,984
Balances with the Central Bank of the Republic of Azerbaijan	4,112	5,597
Total cash and balances with the Central Bank of the Republic of Azerbaijan	**10,745**	**10,581**

The obligatory minimum reserve deposits with the Central Bank of the Republic of Azerbaijan included in the balances with CBAR are restricted balances of AZN 3,985 thousand and AZN 4,033 thousand, respectively, as at December 31, 2013 and 2012. The Bank is entitled to use all funds on its correspondent account provided that average daily balance for 30 days period will be eventually higher than required mandatory reserve.

Cash and cash equivalents for the purposes of the statement of cash flows comprise the following:

	December 31, 2013	December 31, 2012
Cash and balances with the Central Bank of the Republic of Azerbaijan	10,745	10,581
Correspondent accounts and time deposits with original maturities up to 90 days	10,308	4,542
	21,053	15,123
Less minimum reserve deposits with the Central Bank of the Republic of Azerbaijan	(3,985)	(4,033)
Less other blocked accounts with the Central Bank of the Republic of Azerbaijan	(127)	(475)
Total cash and cash equivalents	**16,941**	**10,615**

Other blocked accounts with the Central Bank of the Republic of Azerbaijan inclided in the balances with CBAR amounted to AZN 127 thousand and AZN 475 thousand as at December 31, 2013 and 2012, respectively. These accounts are blocked against the long-term loans obtained from CBAR.

6. DUE FROM BANKS

Due from banks comprise:

	December 31, 2013	December 31, 2012
Term placements	7,857	3,620
Correspondent accounts with other banks	6,377	922
Less: allowance for impairment losses	-	(72)
Total due from banks	**14,234**	**4,470**

Movements in the allowance for impairment losses on balances due from banks for the years ended December 31, 2013 and 2012 are disclosed in Note 18.

As at December 31, 2013 the Bank simultaneously placed with and received short term funds from one bank in different currency of AZN 3,920 thousand.

As at December 31, 2013 and 2012 the Bank had balances due from 1 bank with individual exposure exceeding 10% of the Bank's equity.

7. LOANS TO CUSTOMERS

Loans to customers comprise:

	December 31, 2013	December 31, 2012
Loans to legal entities		
Trade and services	21,266	16,054
Manufacturing	15,995	15,580
Construction	5,553	5,509
Transportation	2,361	2,187
Agriculture	301	1,616
Other	256	86
Total loans to legal entities	45,732	41,032
Loans to individuals		
Purchase of motor vehicles	87,497	58,384
Entrepreneurs	73,970	69,552
Consumer loans	18,655	16,434
Mortgage loans	17,432	11,229
Plastic cards	2,570	1,605
Other	1,879	7,927
Total loans to individuals	202,003	165,131
Gross loans to customers	247,735	206,163
Less: allowance for impairment losses	(23,479)	(27,411)
Total loans to customers	**224,256**	**178,752**

As at December 31, 2013 and 2012 the Bank granted loans to 1 and 2 customers totaling AZN 5,184 thousand and AZN 8,407 thousand, respectively, which individually exceeded 10% of the Bank's equity.

As at December 31, 2013 and 2012 a significant amount of loans (100% of total loans to customers) is granted to companies operating in the Republic of Azerbaijan, which represents a significant geographical concentration in one region.

Analysis by credit quality of loans to customers outstanding as at December 31, 2013 was as follows:

	Corporate	Purchase of motor vehicles	Entrepreneurs	Consumer loans	Mortgage loans	Plastic cards	Other purposes	Total
As at December 31, 2013								
Unimpaired loans collateralized by								
- motor vehicles	-	76,606	775	-	-	-	6	77,387
- real estate	3,339	-	11,095	39	15,155	194	1,789	31,611
- guarantee	8,615	-	21,985	7,330	-	166	-	38,096
- equipment	2,511	-	1,389	2,409	-	12	84	6,405
- securities	4,873	-	246	-	-	-	-	5,119
- cash deposits	231	-	7	4,519	-	1,340	-	6,097
- goods and materials	2,858	-	1,331	2	-	-	-	4,191
- other collateral	-	-	214	68	-	-	-	282
- unsecured loans	80	-	825	2,563	-	646	-	4,114
Total unimpaired loans	**22,507**	**76,606**	**37,867**	**16,930**	**15,155**	**2,358**	**1,879**	**173,302**
Collectively assessed								
Overdue:								
up to 30 days	144	3,789	973	293	208	1	-	5,408
31 to 90 days	67	3,904	504	147	299	9	-	4,930
91 to 180 days	-	184	1,365	92	220	8	-	1,869
181 to 360 days	2,755	263	2,649	196	147	6	-	6,016
over 360 days	4,591	2,751	13,047	997	1,403	188	-	22,977
Total collectively assessed loans	**7,557**	**10,891**	**18,538**	**1,725**	**2,277**	**212**	**-**	**41,200**
Individually impaired								
Overdue:								
181 to 360 days	3,773	-	1,911	-	-	-	-	5,684
over 360 days	11,895	-	15,654	-	-	-	-	27,549
Total individually impaired loans	**15,668**	**-**	**17,565**	**-**	**-**	**-**	**-**	**33,233**
Total loans to customers, gross	**45,732**	**87,497**	**73,970**	**18,655**	**17,432**	**2,570**	**1,879**	**247,735**
Less: allowance for impairment losses	(9,120)	(1,877)	(11,739)	(666)	(26)	(51)	-	(23,479)
Total loans to customers	**36,612**	**85,620**	**62,231**	**17,989**	**17,406**	**2,519**	**1,879**	**224,256**

Analysis by credit quality of loans to customers outstanding as at December 31, 2012 was as follows:

	Corporate	Purchase of motor vehicles	Entrepreneurs	Consumer loans	Mortgage loans	Plastic cards	Other purposes	Total
As at December 31, 2012								
Unimpaired loans collateralized by								
- motor vehicles	1,525	55,243	1,152	272	-	17	27	58,236
- real estate	12,332	14	13,473	3,184	10,913	14	-	39,930
- guarantee	1,397	14	10,041	2,372	8	176	1,777	15,785
- equipment	4,159	-	4,022	950	-	-	69	9,200
- securities	1,395	-	684	161	-	-	-	2,240
- cash deposits	-	-	2,495	590	-	885	1	3,971
- goods and materials	-	-	5,178	1,224	-	-	-	6,402
- other collateral	-	-	578	136	-	-	116	830
- unsecured loans	4,367	-	455	107	-	248	1,141	6,318
Total unimpaired loans	**25,175**	**55,271**	**38,078**	**8,996**	**10,921**	**1,340**	**3,131**	**142,912**
Collectively assessed								
Overdue:								
up to 30 days	4,565	134	2,712	641	308	-	-	8,360
31 to 90 days	225	174	5,661	1,338	-	5	37	7,440
91 to 180 days	3,481	284	1,700	402	-	1	365	6,233
181 to 360 days	1,233	179	7,016	1,658	-	-	564	10,650
over 360 days	2,627	109	8,317	1,965	-	259	1,323	14,600
Total collectively assessed loans	**12,131**	**880**	**25,406**	**6,004**	**308**	**265**	**2,289**	**47,283**
Individually impaired								
Overdue:								
over 360 days	3,726	2,233	6,068	1,434	-	-	2,507	15,968
Total individually impaired loans	**3,726**	**2,233**	**6,068**	**1,434**	**-**	**-**	**2,507**	**15,968**
Total loans to customers, gross	**41,032**	**58,384**	**69,552**	**16,434**	**11,229**	**1,605**	**7,927**	**206,163**
Less: allowance for impairment losses	(5,451)	(3,735)	(12,772)	(3,018)	(708)	(30)	(1,697)	(27,411)
Total loans to customers	**35,581**	**54,649**	**56,780**	**13,416**	**10,521**	**1,575**	**6,230**	**178,752**

The table below summarizes carrying value of loans to customers analysed by type of collateral obtained by the Bank:

As at December 31, 2013	Corporate	Purchase of motor vehicles	Entrepreneurs	Consumer loans	Mortgage loans	Plastic cards	Other purposes	Total
Loans collateralized by								
- motor vehicles	-	87,497	822	54	-	17	6	88,396
- real estate	11,927	-	34,682	312	17,432	216	1,789	66,358
- guarantee	10,598	-	25,730	8,264	-	198	-	44,790
- equipment	9,981	-	6,205	2,528	-	12	84	18,810
- securities	10,057	-	553	-	-	-	-	10,610
- cash deposits	231	-	26	4,522	-	1,362	-	6,141
- goods and materials	2,858	-	1,534	3	-	-	-	4,395
- other collateral	-	-	301	74	-	-	-	375
- unsecured loans	80	-	4,117	2,898	-	765	-	7,860
	45,732	87,497	73,970	18,655	17,432	2,570	1,879	247,735
Less: allowance for impairment losses	(9,120)	(1,877)	(11,739)	(666)	(26)	(51)	-	(23,479)
Total loans to customers	**36,612**	**85,620**	**62,231**	**17,989**	**17,406**	**2,519**	**1,879**	**224,256**

As at December 31, 2012	Corporate	Purchase of motor vehicles	Entrepreneurs	Consumer loans	Mortgage loans	Plastic cards	Other purposes	Total
Loans collateralized by								
- motor vehicles	1,881	58,351	1,306	309	-	118	30	61,995
- real estate	26,997	17	37,008	8,744	11,221	17	-	84,004
- guarantee	1,488	15	11,853	2,801	8	200	6,412	22,777
- equipment	4,372	-	5,449	1,288	-	-	69	11,178
- securities	1,395	-	4,926	1,164	-	-	-	7,485
- cash deposits	181	-	2,497	590	-	913	1	4,182
- goods and materials	220	-	5,287	1,249	-	-	-	6,756
- other collateral	-	-	578	136	-	-	116	830
- unsecured loans	4,498	1	648	153	-	357	1,299	6,956
	41,032	58,384	69,552	16,434	11,229	1,605	7,927	206,163
Less: allowance for impairment losses	(5,451)	(3,735)	(12,772)	(3,018)	(708)	(30)	(1,697)	(27,411)
Total loans to customers	**35,581**	**54,649**	**56,780**	**13,416**	**10,521**	**1,575**	**6,230**	**178,752**

During the years ended December 31, 2013 and 2012 the Bank received non-financial assets by taking possession of collateral it held as security. As at December 31, 2013 and 2012 such assets in amount of AZN 3,365 thousand and AZN 2,014 thousand, respectively, are stated separately in the statement of financial position.

8. PROPERTY AND EQUIPMENT

Property and equipment comprise:

	Buildings	Furniture and fixture	Computer equipment	Vehicles	Other fixed assets	Leasehold improve-ments	Total
Cost							
January 1, 2012	-	1,585	1,713	713	46	1,319	5,376
Additions	3,101	495	619	220	32	277	4,744
Transfers	-	(162)	57	-	105	-	-
Disposals	-	(11)	(31)	(125)	-	-	(167)
December 31, 2012	3,101	1,907	2,358	808	183	1,596	9,953
Additions	-	695	692	80	152	1,847	3,466
Disposals	-	(24)	(47)	-	(68)	-	(139)
December 31, 2013	3,101	2,578	3,003	888	267	3,443	13,280
Accumulated depreciation							
January 1, 2012	-	(1,138)	(836)	(483)	(21)	(661)	(3,139)
Depreciation charge	(74)	(127)	(403)	(133)	(15)	(144)	(896)
Transfers	-	134	(56)	-	(78)	-	-
Eliminated on disposals	-	11	31	125	-	-	167
December 31, 2012	(74)	(1,120)	(1,264)	(491)	(114)	(805)	(3,868)
Depreciation charge	(155)	(396)	(489)	(128)	(26)	(111)	(1,305)
Eliminated on disposals	-	24	47	-	68	-	139
December 31, 2013	(229)	(1,492)	(1,706)	(619)	(72)	(916)	(5,034)
Net book value:							
December 31, 2013	**2,872**	**1,086**	**1,297**	**269**	**195**	**2,527**	**8,246**
December 31, 2012	**3,027**	**787**	**1,094**	**317**	**69**	**791**	**6,085**

As at December 31, 2013 and 2012 included in property and equipment were fully depreciated assets totaling AZN 2,674 thousand and AZN 2,035 thousand, respectively.

9. INTANGIBLE ASSETS

	Software	CIP	Total
Cost			
January 1, 2012	861	272	1,133
Additions	291	194	485
Transfers	401	(401)	-
December 31, 2012	1,553	65	1,618
Additions	534	-	534
Transfers	65	(65)	-
Disposals	(70)	-	(70)
December 31, 2013	2,082	-	2,082
Accumulated amortization			
January 1, 2012	(351)	-	(351)
Charge for the year	(97)	-	(97)
December 31, 2012	(448)	-	(448)
Charge for the year	(168)	-	(168)
Eliminated on disposal	68	-	68
December 31, 2013	(548)	-	(548)
Net book value			
December 31, 2013	**1,534**	**-**	**1,534**
December 31, 2012	**1,105**	**65**	**1,170**

10. OTHER ASSETS

Other assets comprise:

	December 31, 2013	December 31, 2012
Other financial assets		
Amounts in course of settlement	1,108	747
Settlements on money transfers	79	19
Receivables for plastic cards	5	4
Less: allowance for impairment losses	(715)	(688)
Total other financial assets	**477**	**82**
Other non-financial assets		
Prepaid expenses	1,219	31
Prepaid taxes other than income tax	-	59
Prepayments for property, plant and intangible assets	153	126
Other	57	45
Total other assets	**1,906**	**343**

The movements in allowance for impairment losses on other assets are stated in Note 18.

11. REPOSSESSED ASSETS

During the years ended December 31, 2013 and 2012 the Bank received non-financial assets by taking possession of collateral it held as security as assets held for sale at fair value. As at December 31, 2013 and 2012 such assets amounted to AZN 3,365 thousand and AZN 2,014 thousand, respectively. The assets have been subsequently measured at the lower of fair value less cost to dispose or the carrying value, as the appropriate level of management has committed to a plan to sell the assets and an active program to locate a buyer and complete the plan has been initiated. Repossessed collaterals are comprised of real estate. It was intended that the fair value of these assets would be recovered principally through a sale transaction within one year from the date of classification.

12. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

Due to banks and other financial institutions comprise:

	December 31, 2013	December 31, 2012
Loans from government organizations	18,655	13,262
Loans from banks and other financial institutions	17,073	24,538
Loans from Central Bank of the Republic of Azerbaijan	1,120	3,000
Correspondent accounts of other banks	117	40
Total due to banks and other financial institutions	**36,965**	**40,840**

As at December 31, 2013 and 2012, included in loans received from government agencies are loans from the National Fund for Support of Entrepreneurship amounting to AZN 7,245 thousand and AZN 8,811 thousand respectively. These loans have maturity periods from 1 year to 7 years and bear an annual interest rate of 1%. This rate is considered as a market rate as this is rate by which the National Fund for Support of Entrepreneurship lends to local banks in the Republic of Azerbaijan.

As at December 31, 2013 and 2012, included in loans received from government agencies are loans from the Azerbaijan Mortgage Fund amounting to AZN 11,410 thousand and AZN 4,451 thousand, respectively. These loans have maturity periods from 6 year to 30 years and bear an annual interest rate of 1-8%. This rate is considered as a market rate as this is rate by which the Azerbaijan Mortgage Fund lends to local banks in the Republic of Azerbaijan.

The Bank is not obligated to comply with any financial covenants in relation to due to banks and other financial institutions balances as at December 31, 2013 and 2012.

13. CUSTOMER ACCOUNTS

Customer accounts comprise:

	December 31, 2013	December 31, 2012
Time deposits	156,025	119,053
Current and settlement accounts	16,645	12,942
Total customer accounts	**172,670**	**131,995**

As at December 31, 2013 and 2012, customer accounts totaling AZN 502 thousand and AZN 36 thousand, respectively, were held as security against guarantees issued by the Bank.

As at December 31, 2013 and 2012 customer accounts totaling AZN 25,150 thousand and AZN 25,871 thousand (15% and 20% of total deposits by customers), respectively, were due to 10 customers, which represents a significant concentration.

	December 31, 2013	December 31, 2012
Analysis by economic sector/customer type:		
Individuals	141,514	107,658
Insurance	21,273	16,323
Trade	8,058	6,131
Construction and real estate	930	521
Manufacturing	318	85
Transport and communication	138	772
Agriculture	29	9
Embassies	11	202
Other	399	294
Total customer accounts	**172,670**	**131,995**

14. OTHER LIABILITIES

Other liabilities comprise:

	December 31, 2013	December 31, 2012
Other financial liabilities:		
Items in course of settlement	155	49
Accrued expenses	63	61
Provision for guarantees and other commitments	-	255
	218	365
Other non-financial liabilities:		
Taxes payable, other than income tax	195	946
Other	19	24
Total other liabilities	**432**	**1,335**

The movements in provision for guarantees and other commitments are stated in Note 18.

15. SUBORDINATED DEBT

Subordinated debt comprises:

	Currency	Maturity year	Nominal interest rate %	December 31, 2013
Topaz Opportunities (BVI)	USD	2023	12%	6,708
OJSC Uralsib	USD	2023	12%	5,070
ISR Holding LLC	USD	2023	12%	119
Total subordinated debt				**11,897**

In the event of bankruptcy or liquidation of the Bank, repayment of this debt is subordinate to the repayments of the Bank’s liabilities to all other creditors.

The Bank is not obligated to comply with any financial covenants in relation to this subordinated debt.

16. SHARE CAPITAL

As at December 31, 2013 and 2012, share capital consisted of 17,250,000 and 11,250,000 ordinary shares with par value of AZN 2 each. At December 31, 2013 and 2012, there are no issued but outstanding shares:

	Number of authorized, issued and fully paid in ordinary shares	Share capital
January 1, 2012	11,250,000	22,500
Issue of shares	-	-
December 31, 2012	11,250,000	22,500
Issue of shares	6,000,000	12,000
December 31, 2013	17,250,000	34,500

The ultimate controlling party of the Bank is Mr. V. Alekperov.

17. NET INTEREST INCOME

	Year ended December 31, 2013	Year ended December 31, 2012
Interest income comprises:		
Financial assets recorded at amortized cost:		
- impaired financial assets	28,726	29,504
- unimpaired financial assets	4,040	3,765
Total interest income	32,766	33,269
Financial assets recorded at amortized cost comprises:		
Loans to customers	32,676	32,748
Due from banks	90	521
Total interest income on financial assets recorded at amortized cost	32,766	33,269
Interest expense comprises:		
Interest on financial liabilities recorded at amortized cost	(16,980)	(15,108)
Total interest expense	(16,980)	(15,108)
Financial liabilities recorded at amortized cost comprise:		
Customer accounts	(14,960)	(13,894)
Due to banks and other financial institutions	(1,891)	(1,214)
Subordinated debt	(129)	-
Total interest expense on financial liabilities recorded at amortized cost	(16,980)	(15,108)
Net interest income before recovery of provision/(provision) on interest bearing financial assets	**15,786**	**18,161**

18. ALLOWANCE FOR IMPAIRMENT LOSSES AND OTHER PROVISIONS

The movements in allowance for impairment losses on interest bearing assets were as follows:

	Due from banks	Loans to customers	Total
December 31, 2011	176	24,883	25,059
Write off of loans	-	(881)	(881)
(Recovery of provision)/additional provisions recognized	(104)	3,409	3,305
December 31, 2012	72	27,411	27,483
Write off of loans	-	(3,922)	(3,922)
Recovery of provision	(72)	(10)	(82)
December 31, 2013	**-**	**23,479**	**23,479**

The movements in other provisions were as follows:

	Other assets	Repossessed assets	Guarantees and other commitments	Total
December 31, 2011	700	138	165	1,003
(Recovery of provision)/additional provisions recognized	(12)	241	90	319
December 31, 2012	688	379	255	1,322
Additional provisions recognized /(recovery of provision)	27	12	(255)	(216)
December 31, 2013	**715**	**391**	**-**	**1,106**

19. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprises:

	Year ended December 31, 2013	Year ended December 31, 2012
Dealing, net	538	525
Translation differences, net	(21)	(37)
Total net gain on foreign exchange operations	**517**	**488**

20. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	Year ended December 31, 2013	Year ended December 31, 2012
Fee and commission income:		
Settlements	1,408	1,223
Cash operations	855	1,598
Agency fees	286	222
Plastic card operations	277	216
Guarantees	135	2
Other	18	69
Total fee and commission income	**2,979**	**3,330**
Fee and commission expense:		
Plastic card operations	(149)	(110)
Settlements	(61)	(41)
Agency fees	(45)	(209)
Cash operations	(16)	(3)
Total fee and commission expense	**(271)**	**(363)**

21. OPERATING EXPENSES

Operating expenses comprise:

	Year ended December 31, 2013	Year ended December 31, 2012
Staff costs	8,308	6,863
Rent expense	2,309	1,902
Professional services	1,334	1,297
Depreciation and amortization	1,473	993
Advertising and marketing expenses	675	656
Security expenses	612	655
Communication expenses	418	365
Insurance expenses	318	303
Payments to the Deposit Insurance Fund	294	212
Office supplies and printing expenses	253	280
Entertainment expenses	244	178
Business trip expenses	222	201
Computer software cost	168	123
Taxes other than income tax	90	97
Transportation and travel expenses	89	76
Repair and maintenance expenses	80	102
Utilities expenses	80	73
Legal and court expenses	74	30
Staff training	35	39
Fines and penalties to Ministry of Taxes	-	135
Other expenses	11	14
Total operating expenses	**17,087**	**14,594**

22. INCOME TAXES

The Bank measures and records its current income tax payable and its tax bases in its assets and liabilities in accordance with the tax regulations of the Republic of Azerbaijan where the Bank operates, which may differ from IFRS.

The Bank is subject to certain permanent tax differences due to the non-tax deductibility of certain expenses and certain income being treated as non-taxable for tax purposes.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at December 31, 2013 and 2012 relate mostly to different methods/timing of income and expense recognition as well as to temporary differences generated by tax – book bases' differences for certain assets.

The tax rate used for the reconciliations below is the corporate tax rate of 20% payable by corporate entities in the Republic of Azerbaijan on taxable profits (as defined) under tax law in that jurisdiction.

Deferred tax assets as at December 31, 2013 and 2012 comprise:

	December 31, 2013	**December 31, 2012**
Deferred tax assets in relation to:		
Loans to customers	1,403	1,250
Property, equipment and intangible assets	(303)	56
Net deferred tax assets	**1,100**	**1,306**

The effective tax rate reconciliation is as follows for the years ended December 31, 2013 and 2012:

	Year ended December 31, 2013	**Year ended December 31, 2012**
Profit before income tax	2,232	3,414
Tax at the statutory tax rate (20%)	(446)	(683)
Adjustments recognized in the current year in relation to the current tax of prior years	-	(192)
Tax effect of permanent differences	(300)	(99)
Income tax expense	**(746)**	**(974)**
Current income tax expense	(540)	(1,229)
Adjustments recognized in the current year in relation to the current tax of prior years	-	(192)
Change in the deferred tax asset	(206)	447
Income tax expense	**(746)**	**(974)**

23. EARNINGS PER SHARE

The earnings and weighted average number of ordinary shares used in calculation of basic and diluted earnings per share are as follows:

	Year ended December 31, 2013	**Year ended December 31, 2012**
Net profit for the year attributable to owners of the Bank	1,486	2,440
Weighted average number of ordinary shares for the purpose of basic and diluted earnings per share (in thousands)	13,206	11,250
Earnings per share – basic and diluted (AZN)	**0.11**	**0.22**

24. COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Bank is a party to financial instruments with off-balance sheet risk in order to meet the needs of its customers. These instruments, involving varying degrees of credit risk, are not reflected in the statement of financial position.

The Bank's uses the same credit control and management policies in undertaking off-balance sheet commitments as it does for on-balance operations.

Provision for losses on contingent liabilities totaled Nil and AZN 255 thousand as at December 31, 2013 and 2012, respectively.

As at December 31, 2013 and 2012 contingent liabilities comprise:

	December 31, 2013	December 31, 2012
Contingent liabilities and credit commitments		
Guarantees issued and similar commitments	15,091	850
Forward contracts	13,724	24,696
Commitments on loans and unused credit lines	5,912	4,260
Total contingent liabilities and credit commitments	**34,727**	**29,806**

Extension of loans to customers within credit line limits is approved by the Bank on a case-by-case basis and depends on borrowers' financial performance, debt service and other conditions. As at December 31, 2013 and 2012 such unused credit lines come to AZN 5,912 thousand and AZN 4,260 thousand, respectively.

Operating lease commitments

As at December 31, 2013 and 2012, the Bank does not have material commitments under non-cancelable operating leases where the Bank is the lessee.

Legal proceedings

From time to time and in the normal course of business, claims against the Bank are received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these financial statements.

Taxation

Commercial legislation of the Republic of Azerbaijan, including tax legislation, may allow more than one interpretation. In addition, there is a risk of tax authorities making arbitrary judgments of business activities. If a particular treatment, based on management's judgment of the Bank's business activities, was to be challenged by the tax authorities, the Bank may be assessed additional taxes, penalties and interest.

Such uncertainty may relate to the valuation of financial instruments, valuation of provision for impairment losses and the market pricing of deals. Additionally such uncertainty may relate to the valuation of temporary differences on the provision and recovery of the provision for impairment losses on loans to customers and receivables, as an underestimation of the taxable profit. The management of the Bank believes that it has accrued all tax amounts due and therefore no allowance has been made in the financial statements.

Generally, taxpayers are subject to tax audits with respect to three calendar years preceding the year of the audit. However, completed audits do not exclude the possibility of subsequent additional tax audits performed by upper-level tax inspectorates reviewing the results of tax audits of their subordinate tax inspectorates. In the case of criminal investigation statute of limitation maybe extended up to seven years based on the court decision.

Operating environment

Emerging markets such as Azerbaijan are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. Laws and regulations affecting businesses in Azerbaijan continue to change rapidly, tax and regulatory frameworks are subject to varying interpretations. The future economic direction of Azerbaijan is heavily influenced by the fiscal and monetary policies adopted by the government, together with developments in the legal, regulatory, and political environment.

Because Azerbaijan produces and exports large volumes of oil and gas, its economy is particularly sensitive to the price of oil and gas on the world market.

25. FAIR VALUE OF FINANCIAL INSTRUMENTS

IFRS defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Fair value of financial assets and financial liabilities that are not measured at fair value on a recurring basis

The directors consider that the carrying amounts of financial assets and financial liabilities recognised in the financial statements approximate their fair values as at December 31, 2013 and 2012.

		31 December 2013	
	Level 2	**Level 3**	**Total**
Financial assets:			
Balances with CBAR	4,112	-	4,112
Due form banks	14,234	-	14,234
Loans to customers	224,256	-	224,256
Available-for-sale investments	-	304	304
Other financial assets	477	-	477
Financial liabilities:			
Due to banks and other financial institutions	36,965	-	36,965
Customer accounts	172,670	-	172,670
Other financial liabilities	218	-	218
Subordinated debt	11,897	-	11,897

		31 December 2012	
	Level 2	**Level 3**	**Total**
Financial assets:			
Balances with CBAR	5,597	-	5,597
Due form banks	4,470	-	4,470
Loans to customers	178,752	-	178,752
Available-for-sale investments	-	304	304
Other financial assets	82	-	82
Financial liabilities:			
Due to banks and other financial institutions	40,840	-	40,840
Customer accounts	131,995	-	131,995
Other financial liabilities	365	-	365

The fair values of the financial assets and financial liabilities included in the level 2 and 3 categories above have been determined in accordance with generally accepted pricing models based on a discounted cash flow analysis, with the most significant inputs being the discount rate that reflects the credit risk of counterparties.

26. CAPITAL RISK MANAGEMENT

The Bank's objectives when managing capital is to comply with the capital requirements set by the Central Bank of the Republic of Azerbaijan, to safeguard the Bank's ability to continue as a going concern and to maintain a sufficient capital base to achieve a capital adequacy ratio of at least 12%. Compliance with capital adequacy ratios set by the Central Bank of the Republic of Azerbaijan is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's Financial Director, Chief Accountant, Chief of Audit Department, Head of Audit Committee and the Head of Supervisory Board. Other objectvies of capital management are evaluated annually.

Under the current capital requirements set by the Central Bank of the Republic of Azerbaijan, banks have to: (a) hold the minimum level of share capital of AZN 10,000,000 (2012: AZN 10,000,000); (b) maintain a ratio of regulatory capital to risk weighted assets ("statutory capital ratio") at or above a prescribed minimum of 12% (2012: 12%) and (c) maintain a ratio of tier-1 capital to the risk-weighted assets (the "tier-1 capital ratio") at or above the prescribed minimum of 6% (2012: 6%).

The Central Bank of Azerbaijan Republic has taken a decision to increase minimum level of capital to AZN 50,000,000 at July 25, 2012. The requirement is effective from January 1, 2015. In order to keep the level of capital in compliance with the CBAR's requirement, the Bank has obtained subordinated debt (see Note 15).

The capital structure of the Bank as at December 31, 2013 and 2012, calculated in accordance with requirements of the Central Bank of the Republic of Azerbaijan is presented in following table:

	Year ended December 31, 2013	**Year ended December 31, 2012**
Composition of regulatory capital:		
Tier 1 capital:		
Share capital	34,500	22,500
Share premium	401	401
Retained earnings	7,846	5,406
Less: Intangible assets	(1,534)	(1,170)
Less: Deferred tax assets	(1,100)	(1,306)
Total qualifying tier 1 capital	**40,113**	**25,831**
Current year profit	1,486	2,440
1.25% of risk-weighted not exceeding provisions for assets	3,389	2,439
Subordinated debt	11,897	-
Total qualifying Tier 2 capital limited to 100% of Tier 1 capital	**16,772**	**4,879**
Total regulatory capital	**56,885**	**30,710**
Total risk-weighted assets	**271,127**	**195,097**
Capital Ratios:		
Tier 1 capital	15%	13%
Total capital	21%	16%

As at December 31, 2013 and 2012, the Bank included in the computation of Total capital for Capital adequacy purposes the subordinated debt received, limited to 50% of Tier 1 capital. In the event of bankruptcy or liquidation of the Bank, repayment of this debt is subordinate to the repayments of the Bank's liabilities to all other creditors.

27. RISK MANAGEMENT POLICIES

Management of risk is fundamental to the Bank's banking business and is an essential element of the Bank's operations. The main risks inherent to the Bank's operations are those related to:

- Credit risk
- Liquidity risk
- Market risk

The Bank recognizes that it is essential to have efficient and effective risk management processes in place. To enable this, the Bank has established a risk management framework, whose main purpose is to protect the Bank from risk and allow it to achieve its performance objectives. Through the risk management framework, the Bank manages the following risks:

Credit risk

The Bank is exposed to credit risk which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

Risk management and monitoring is performed within set limits of authority. These processes are performed by the Credit Committees and the Bank's Management Board. Before any application is made by the Credit Committee, all recommendations on credit processes (borrower's limits approved, or amendments made to loan agreements, etc.) are reviewed and approved by the branch risk-manager or the Risk Management Department. Daily risk management is performed by the Head of Credit Departments and Branch Credit Divisions.

The Bank structures the level of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Limits on the level of credit risk by a borrower and a product (by industry sector) are approved quarterly by the Management Board. The exposure to any one borrower including banks and brokers is further restricted by sub-limits covering on and off-balance sheet exposures which are set by the Credit Committee. Actual exposures against limits are monitored daily.

Where appropriate, and in the case of most loans, the Bank obtains collateral and corporate and personal guarantees. A certain portion of loans is personal lending, where no such facilities can be obtained. Such risks are monitored on a continuous basis and subject to annual or more frequent reviews.

Commitments to extend credit represent unused portions of credit in the form of loans, guarantees or letters of credit. The credit risk on off-balance sheet financial instruments is defined as a probability of losses due to the inability of counterparty to comply with the contractual terms and conditions. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of the loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank applies the same credit policy to the contingent liabilities as it does to the statement of financial position financial instruments, i.e. the one based on the procedures for approving the granting of loans, using limits to mitigate the risk, and current monitoring. The Bank monitors the term to maturity of off balance sheet contingencies because longer term commitments generally have a greater degree of credit risk than short-term commitments.

Maximum exposure of credit risk

The Bank's maximum exposure to credit risk varies significantly and is dependant on both individual risks and general market economy risks.

The following table presents the maximum exposure to credit risk of balance sheet and off balance sheet financial assets. For financial assets in the balance sheet, the maximum exposure is equal to the carrying amount of those assets prior to any offset or collateral. The Bank's maximum exposure to credit risk under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

	Maximum exposure	Offset	Net exposure after offset	Collateral pledged	Net exposure
December 31, 2013					
Balances with CBAR	4,112	-	4,112	-	4,112
Due from banks	14,234	(3,920)	10,314	-	10,314
Loans to customers	224,256	(6,141)	218,115	(211,361)	6,754
Available-for-sale investments	304	-	304	-	304
Other financial assets	477	-	477	-	477
Guarantees issued and similar commitments	15,091	(502)	14,589	(235)	14,354
Commitments on loans and unused credit lines	5,912	(4,170)	1,742	(1,155)	587
December 31, 2012					
Balances with CBAR	5,597	-	5,597	-	5,597
Due from banks	4,470	-	4,470	-	4,470
Loans to customers	178,752	(4,182)	174,570	(168,172)	6,398
Available-for-sale investments	304	-	304	-	304
Other financial assets	82	-	82	-	82
Guarantees issued and similar commitments	850	(36)	814	(726)	88
Commitments on loans and unused credit lines	4,260	(3,332)	928	(47)	881

Off-balance sheet risk

The Bank applies fundamentally the same risk management policies for off-balance sheet risks as it does for its on-balance sheet risks. In the case of commitments to lend, customers and counterparties will be subject to the same credit management policies as for loans and advances. Collateral may be sought depending on the strength of the counterparty and the nature of the transaction.

Geographical concentration

The Assets and Liabilities Management Committee ("ALMC") exercises control over the risk in the legislation and regulatory arena and assesses its influence on the Bank's activity. This approach allows the Bank to minimize potential losses from the investment climate fluctuations in the Republic of Azerbaijan.

The geographical concentration of assets and liabilities is set out below:

	The Republic of Azerbaijan	OECD countries	Other non-OECD countries	December 31, 2013 Total
NON-DERIVATIVE FINANCIAL ASSETS				
Cash and balances with CBAR	10,745	-	-	10,745
Due from banks	9,076	5,086	72	14,234
Loans to customers	223,604	-	652	224,256
Available-for-sale investments	304	-	-	304
Other financial assets	477	-	-	477
Total non-derivative financial assets	**244,206**	**5,086**	**724**	**250,016**
NON-DERIVATIVE FINANCIAL LIABILITIES				
Due to banks and other financial institutions	24,814	1,974	10,177	36,965
Customer accounts	156,923	2,211	13,536	172,670
Other financial liabilities	119	99	-	218
Subordinated debt	119	-	11,778	11,897
Total non-derivative financial liabilities	**181,975**	**4,284**	**35,491**	**221,750**
NET POSITION ON NON-DERIVATIVE FINANCIAL INSTRUMENTS	**62,231**	**802**	**(34,767)**	

	The Republic of Azerbaijan	OECD countries	Other non-OECD countries	December 31, 2012 Total
NON-DERIVATIVE FINANCIAL ASSETS				
Cash and balances with CBAR	10,581	-	-	10,581
Due from banks	158	354	3,958	4,470
Loans to customers	177,923	-	829	178,752
Available-for-sale investments	304	-	-	304
Other financial assets	22	24	36	82
Total non-derivative financial assets	**188,988**	**378**	**4,823**	**194,189**
NON-DERIVATIVE FINANCIAL LIABILITIES				
Due to banks and other financial institutions	23,610	-	17,230	40,840
Customer accounts	113,560	1,351	17,084	131,995
Other financial liabilities	354	11	-	365
Total non-derivative financial liabilities	**137,524**	**1,362**	**34,314**	**173,200**
NET POSITION ON NON-DERIVATIVE FINANCIAL INSTRUMENTS	**51,464**	**(984)**	**(29,491)**	

Collateral

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For commercial lending, charges over real estate properties, inventory
- For retail lending, mortgages over residential properties.

At December 31, 2013, the fair value of collateral that the Bank holds relating to loans individually determined to be impaired amounts to AZN 1,909 thousand. The collateral consists of real estate and equipment.

During the year, the Bank took possession of real estate with a carrying value of AZN 1,351 thousand at the statement of financial position date, which the Bank is in the process of selling.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

Credit quality by class of financial asset

The following table details credit ratings of financial assets held by the Bank:

December 31, 2013	**A**	**BBB**	**<BBB**	**Not rated**	**Total**
Due from banks	5,086	27	4,105	5,016	14,234
Loans to customers	-	-	-	224,256	224,256
Available-for-sale investments	-	-	-	304	304
Other financial assets	-	-	-	477	477
December 31, 2012					
Due from banks	354	19	3,883	214	4,470
Loans to customers	-	-	-	178,752	178,752
Available-for-sale investments	-	-	-	304	304
Other financial assets	-	-	-	82	82

The Bank enters into numerous transactions where the counterparties are not rated by international rating agencies. The Bank has developed internal models, which allow it to determine the rating of counterparties, which are comparable to rating of international rating agencies.

A model of the borrower's scoring assessment has been developed in the Bank to assess and decide on loans to corporate customers as well as small and medium-sized businesses. The scoring model is developed relating to standard loan products and includes key performance indicators of borrowers: financial situation, relations with the borrower, management quality, target use, location, credit history, collateral, etc.

The scoring assessment based on the borrower's parameters is one of the main factors for the decision-making process relating to loans.

A methodology of evaluation of borrowers-individuals is based on following criteria: education, occupancy, financial position, credit history, property owned by the borrower. Based on information obtained the maximum limit of a loan is calculated. The maximum limit of a loan is calculated using a ratio of debt pressure on a borrower.

The Bank applies internal methodologies to specific corporate loans and groups of retail loans. The scoring methodologies are tailor-made for specific products and are applied at various stages over the life of the loan. As a result, it is not possible to make a cross-product score comparison which would agree to the outstanding balance of loans to customers per the statement of financial position. As such, more detailed information is not being presented.

Financial assets other than loans to customers are graded according to the current credit rating they have been issued by an internationally regarded agency such as Fitch, Standard & Poor's and Moody's. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade.

As at December 31, 2013 and 2012 the balances with the CBAR amounted to 4,112 thousand and AZN 5,597 thousand, respectively. The credit rating of the Republic of Azerbaijan according to the international rating agencies in 2013 corresponded to BBB- (2012: BBB-).

Liquidity risk

Liquidity risk refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due.

The ALMC controls these types of risks by means of maturity analysis, determining the Bank's strategy for the next financial period. Current liquidity is managed by the Treasury Department, which deals in the money markets for current liquidity support and cash flow optimization.

In order to manage liquidity risk, the Bank performs daily monitoring of future expected cash flows on clients' and banking operations, which is a part of the assets/liabilities management process. The Management Board sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level on interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

An analysis of the liquidity risk is presented in the following table. The presentation below is based upon the information provided internally to key management personnel of the Bank.

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	December 31, 2013 Total
NON-DERIVATIVE FINANCIAL ASSETS								
Fixed interest rate instruments								
Due from banks	6.33%	-	3,931	-	3,926	-	-	7,857
Loans to customers	19.58%	9,845	19,759	97,620	87,844	9,188	-	224,256
Total fixed interest bearing financial assets		9,845	23,690	97,620	91,770	9,188	-	232,113
Non-interest bearing financial assets								
Cash and balances with the CBAR		7,178	413	2,222	930	2	-	10,745
Due from banks		6,377	-	-	-	-	-	6,377
Available-for-sale investments		-	-	-	-	-	304	304
Other financial assets		477	-	-	-	-	-	477
Total non-interest bearing financial assets		14,032	413	2,222	930	2	304	17,903
Total non-derivative financial assets		**23,877**	**24,103**	**99,842**	**92,700**	**9,190**	**304**	**250,016**
NON-DERIVATIVE FINANCIAL LIABILITIES								
Fixed interest rate instruments								
Due to banks and other financial institutions	4.50%	5,013	4,912	8,047	236	18,640	-	36,848
Customer accounts	10.62%	6,253	17,343	93,310	39,051	68	-	156,025
Subordinated debts	12.00%	-	-	-	-	11,897	-	11,897
Total fixed interest bearing financial liabilities		11,266	22,255	101,357	39,287	30,605	-	204,770
Non-interest bearing financial liabilities								
Due to banks and other financial institutions		117	-	-	-	-	-	117
Customer accounts		16,645	-	-	-	-	-	16,645
Other financial liabilities		218	-	-	-	-	-	218
Total non-interest bearing financial liabilities		16,980	-	-	-	-	-	16,980
Total non-derivative financial liabilities		**28,246**	**22,255**	**101,357**	**39,287**	**30,605**	**-**	**221,750**
Interest sensitivity gap		(1,421)	1,435	(3,737)	52,483	(21,417)		
Cumulative interest sensitivity gap		**(1,421)**	**14**	**(3,723)**	**48,760**	**27,343**		
Liquidity gap		(4,369)	1,848	(1,515)	53,413	(21,415)		
Cumulative liquidity gap		**(4,369)**	**(2,521)**	**(4,036)**	**49,377**	**27,962**		

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	December 31, 2012 Total
NON-DERIVATIVE FINANCIAL ASSETS								
Fixed interest rate instruments								
Due from banks	0.30%	253	3,295	-	-	-	-	3,548
Loans to customers	20.00%	26,458	12,982	72,004	29,589	37,719	-	178,752
Total fixed interest bearing financial assets		26,711	16,277	72,004	29,589	37,719	-	182,300
Non-interest bearing financial assets								
Cash and balances with the CBAR		6,746	356	2,185	1,293	1	-	10,581
Due from banks		922	-	-	-	-	-	922
Available-for-sale investments		-	-	-	-	-	304	304
Other financial assets		63	-	19	-	-	-	82
Total non-interest bearing financial assets		7,731	356	2,204	1,293	1	304	11,889
Total non-derivative financial assets		**34,442**	**16,633**	**74,208**	**30,882**	**37,720**	**304**	**194,189**
NON-DERIVATIVE FINANCIAL LIABILITIES								
Fixed interest rate instruments								
Due to banks and other financial institutions	4.31%	7,559	11,927	15,967	1,400	3,947	-	40,800
Customer accounts	11.99%	6,758	10,434	63,963	37,873	25	-	119,053
Total fixed interest bearing financial liabilities		14,317	22,361	79,930	39,273	3,972	-	159,853
Non-interest bearing financial liabilities								
Due to banks and other financial institutions		40	-	-	-	-	-	40
Customer accounts		12,942	-	-	-	-	-	12,942
Other financial liabilities		138	60	167	-	-	-	365
Total non-interest bearing financial liabilities		13,120	60	-	-	-	-	13,347
Total non-derivative financial liabilities		**27,437**	**22,421**	**80,097**	**39,273**	**3,972**	**-**	**173,200**
Interest sensitivity gap		12,394	(6,084)	(7,926)	(9,684)	33,747		
Cumulative interest sensitivity gap		**12,394**	**6,310**	**(1,616)**	**(11,300)**	**22,447**		
Liquidity gap		7,005	(5,788)	(5,889)	(8,391)	33,748		
Cumulative liquidity gap		**7,005**	**1,217**	**(4,672)**	**(13,063)**	**20,685**		

In the table above, the terms to maturity correspond to the contractual terms. However, individuals are entitled to terminate the deposit agreement ahead of schedule according to effective laws.

The following tables detail the Bank's remaining contractual maturity for its non-derivative financial liabilities with agreed repayment periods. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Bank can be required to pay. The tables include both interest and principal cash flows. To the extent that interest flows are floating rate, the undiscounted amount is derived from interest rate curves at the end of the reporting period. The contractual maturity is based on the earliest date on which the Bank may be required to pay.

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	December 31, 2013 Total
Fixed interest rate instruments							
Due to banks and other financial institutions	4.50%	5,142	5,148	8,670	2,196	27,204	48,360
Customer accounts	10.62%	7,860	21,546	98,671	45,870	100	174,047
Subordinated debt	12.00%	118	235	1,059	5,648	19,036	26,096
Total fixed interest bearing financial liabilities		13,120	26,929	108,400	53,714	46,340	248,503
Non-interest bearing instruments							
Due to banks and other financial institutions		117	-	-	-	-	117
Customer accounts		16,645	-	-	-	-	16,645
Other financial liabilities		218	-	-	-	-	218
Liabilities on financial guarantees		891	2,627	11,573	-	-	15,091
Commitments on loans and unused credit lines		267	504	3,485	1,656	-	5,912
Total non-interest bearing financial liabilities and commitments		18,138	3,131	15,058	1,656	-	37,983
Total financial liabilities and commitments		**31,258**	**30,060**	**123,458**	**55,370**	**46,340**	**286,486**

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	December 31, 2012 Total
Fixed interest rate instruments							
Due to banks and other financial institutions	4.31%	7,801	12,250	16,942	3,323	5,378	45,694
Customer accounts	11.99%	7,901	12,583	70,243	41,974	36	132,737
Total fixed interest bearing financial liabilities		15,702	24,833	87,185	45,297	5,414	178,431
Non-interest bearing instruments							
Due to banks and other financial institutions		40	-	-	-	-	40
Customer accounts		12,942	-	-	-	-	12,942
Other financial liabilities		138	60	167	-	-	365
Liabilities on financial guarantees		295	-	555	-	-	850
Commitments on loans and unused credit lines		165	570	1,324	2,201	-	4,260
Total non-interest bearing financial liabilities and commitments		13,580	630	2,046	2,201	-	18,457
Total financial liabilities and commitments		**29,282**	**25,463**	**89,231**	**47,498**	**5,414**	**196,888**

The amounts included above for financial guarantee contracts are the maximum amounts the Bank could be forced to settle under the arrangement for the full guaranteed amount if that amount is claimed by the counterparty to the guarantee. Based on expectations at the end of the reporting period, the Bank considers that it is more likely than not that no amount will be payable under the arrangement. However, this estimate is subject to change depending on the probability of the counterparty claiming under the guarantee which is a function of the likelihood that the financial receivables held by the counterparty which are guaranteed suffer credit losses.

The maximum amount the Bank could be forced to settle under the financial guarantee contracts if the fully guaranteed amount is claimed by the counterparty to the guarantee is AZN 15,091 thousand (2012: AZN 850 thousand).

Market risk

Market risk is that the risk that the Bank's earnings or capital or its ability to meet business objectives will be adversely affected by changes in the level or volatility of market rates or prices. Market risk covers interest rate risk, currency risk, credit spreads, commodity prices and equity prices that the Bank is exposed to. There have been no changes as to the way the Bank measures risk or to the risk it is exposed or the manner in which these risks are managed and measured.

The Bank is exposed to interest rate risks as entities in the Bank borrow funds at both fixed and floating rates. The risk is managed by the Bank maintaining an appropriate mix between fixed and floating rate borrowings.

The ALMC also manages interest rate and market risks by matching the Bank's interest rate position, which provides the Bank with a positive interest margin. The Treasury Department conducts monitoring of the Bank's current financial performance, estimates the Bank's sensitivity to changes in interest rates and its influence on the Bank's profitability.

The majority of the Bank's loan contracts and other financial assets and liabilities that bear interest are either fixed and contain clauses enabling the interest rate to be changed at the option of the lender. The Bank monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

Interest rate sensitivity

The Bank manages fair value interest rate risk through periodic estimation of potential losses that could arise from adverse changes in market conditions. The Treasury Department conducts monitoring of the Bank's current financial performance, estimates the Bank's sensitivity to changes in fair value interest rates and its influence on the Bank's profitability.

The sensitivity analyses below have been determined based on the exposure to interest rates for both derivatives and non-derivative instruments at the end of the reporting period. For floating rate liabilities, the analysis is prepared assuming the amount of the liability outstanding at the end of the reporting period was outstanding for the whole year. A 50 basis point increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

If interest rates had been 50 basis points higher/lower and all other variables were held constant, the Bank's total profit or loss for the year ended December 31, 2013 would increase/decrease by AZN 137 thousand (2012: total profit or loss would increase/decrease by AZN 112 thousand). This is mainly attributable to the Bank's exposure to interest rates on its fixed rates borrowings.

Currency risk

Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The ALMC controls currency risk by management of the open currency position on the estimated basis of AZN devaluation and other macroeconomic indicators, which gives the Bank an opportunity to minimize losses from significant currency rates fluctuations toward its national currency. The Treasury Department performs daily monitoring of the Bank's open currency position with the aim to match the requirements of the Central Bank of the Republic of Azerbaijan.

The Bank's exposure to foreign currency exchange rate risk is presented in the table below:

	AZN	USD USD 1 = AZN 0.7845	EUR EUR 1 = AZN 1.0780	Other currency	December 31, 2013 Total
Non-derivative financial assets					
Cash and balances with CBAR	6,137	3,697	759	152	10,745
Due form banks	3,933	10,243	49	9	14,234
Loans to customers	167,129	51,729	5,398	-	224,256
Available-for-sale investments	304	-	-	-	304
Other financial assets	171	306	-	-	477
Total non-derivative financial assets	**177,674**	**65,975**	**6,206**	**161**	**250,016**
Non-derivative financial liabilities					
Due to banks and other financial institutions	19,786	12,584	4,595	-	36,965
Customer accounts	113,460	54,685	4,515	10	172,670
Other financial liabilities	84	133	-	1	218
Subordinated debt	-	11,897	-	-	11,897
Total non-derivative financial liabilities	**133,330**	**79,299**	**9,110**	**11**	**221,750**
OPEN BALANCE SHEET POSITION	**44,344**	**(13,324)**	**(2,904)**	**150**	
Derivative financial instruments					
- foreign exchange forward contracts	(13,724)	13,724	-	-	
OPEN POSITION	**30,620**	**400**	**(2,904)**	**150**	

	AZN	USD USD 1 = AZN 0.7850	EUR EUR 1 = AZN 1.0377	Other currency	December 31, 2012 Total
Non-derivative financial assets					
Cash and balances with CBAR	6,687	3,464	233	197	10,581
Due form banks	-	477	3,553	440	4,470
Loans to customers	136,401	36,763	5,588	-	178,752
Available-for-sale investments	304	-	-	-	304
Other financial assets	17	47	12	6	82
Total non-derivative financial assets	**143,409**	**40,751**	**9,386**	**643**	**194,189**
Non-derivative financial liabilities					
Due to banks and other financial institutions	19,794	17,032	4,014	-	40,840
Customer accounts	76,475	49,565	5,162	793	131,995
Other financial liabilities	339	26	-	-	365
Total non-derivative financial liabilities	**96,608**	**66,623**	**9,176**	**793**	**173,200**
OPEN BALANCE SHEET POSITION	**46,801**	**(25,872)**	**210**	**(150)**	
Derivative financial instruments					
- foreign exchange forward contracts	(24,696)	24,696	-	-	
OPEN POSITION	**22,105**	**(1,176)**	**210**	**(150)**	

Currency risk sensitivity

The following table details the Bank's sensitivity to a 10% increase and decrease in the AZN against the relevant foreign currencies. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations with the Bank where the denomination of the loan is in a currency other than the functional currency of the lender or the borrower. A positive number below indicates an increase in profit and other equity where the AZN strengthens 10% against the relevant currency. For a 10% weakening of the AZN against the relevant currency, there would be a comparable impact on the profit and other equity, and the balances below would be negative.

	USD impact			**EUR impact**	
	2013	**2012**		**2013**	**2012**
Profit before tax	40	(118)	(i)	(290)	(21)

(i) This is mainly attributable to the exposure outstanding on USD and EUR receivables and payables in the Bank at the end of the reporting period.

In management's opinion, the sensitivity analysis is unrepresentative of the inherent foreign exchange risk because the year end exposure does not reflect the exposure during the year.

Limitations of sensitivity analysis

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

The sensitivity analyses do not take into consideration that the Bank's assets and liabilities are actively managed. Additionally, the financial position of the Bank may vary at the time that any actual market movement occurs. For example, the Bank's financial risk management strategy aims to manage the exposure to market fluctuations. As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation and taking other protective action. Consequently, the actual impact of a change in the assumptions may not have any impact on the liabilities, whereas assets are held at market value in the statement of financial position. In these circumstances, the different measurement bases for liabilities and assets may lead to volatility in shareholder equity.

Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Bank's view of possible near-term market changes that cannot be predicted with any certainty; and the assumption that all interest rates move in an identical fashion.

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but it endeavours to manage these risks through a control framework and by monitoring and responding to potential risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes.

28. TRANSACTIONS WITH RELATED PARTIES

Details of transactions between the Bank and related parties are disclosed below:

	December 31, 2013		December 31, 2012	
	Related party balances	**Total category as per the financial statements caption**	**Related party balances**	**Total category as per the financial statements caption**
Loans to customers		247,735		206,163
- shareholders and entities in which a substantial interest is owned by shareholders of the Bank	-		899	
-key management personnel of the Bank or its parent	765		967	
Allowance for impairment losses on loans to customers		(23,479)		(27,411)
- shareholders and entities in which a substantial interest is owned by shareholders of the Bank	-		(19)	
-key management personnel of the Bank or its parent	(1)		(20)	
Customer accounts		(172,670)		(131,995)
- shareholders and entities in which a substantial interest is owned by shareholders of the Bank	(2,646)		(1,734)	
- key management personnel of the Bank or its parent	(736)		(635)	
Due to banks and other financial institutions		(36,965)		(40,840)
- shareholders and entities in which a substantial interest is owned by shareholders of the Bank	(4,289)		(10,315)	
Subordinated debt		(11,897)		-
- shareholders and entities in which a substantial interest is owned by shareholders of the Bank	(11,897)		-	
Commitments on loans and unused credit lines		(5,912)		(4,260)
- key management personnel of the Bank or its parent	(58)		-	

The remuneration of the Bank's management was as follows:

	Year ended December 31, 2013		Year ended December 31, 2012	
	Related party transactions	**Total category as per the financial statements caption**	**Related party transactions**	**Total category as per the financial statements caption**
Key management personnel compensation:				
- short-term employee benefits (Note 21)	783	8,308	487	6,863
Total	**783**	**8,308**	**487**	**6,863**

Included in the statement of profit or loss and other comprehensive income for the years ended December 31, 2013 and 2012 are the following amounts which were recognized in transactions with related parties:

	2013		2012	
	Related party transactions	**Total category as per the financial statements caption**	**Related party transactions**	**Total category as per the financial statements caption**
Interest income		32,766		33,269
- shareholders and entities in which a substantial interest is owned by shareholders of the Bank	-		203	
-key management personnel of the Bank or its parent	112		125	
Interest expense		(16,980)		(15,108)
- shareholders and entities in which a substantial interest is owned by shareholders of the Bank	(223)		(64)	
-key management personnel of the Bank or its parent	(92)		(83)	
Recovery of provision/(provision) on interest bearing assets		82		(3,305)
- shareholders and entities in which a substantial interest is owned by shareholders of the Bank	19		(13)	
-key management personnel of the Bank or its parent	19		(1)	