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**OPEN JOINT STOCK  
COMPANY BANK  
OF BAKU**

**Consolidated Financial Statements**  
For the Year Ended December 31, 2013

# OPEN JOINT STOCK COMPANY BANK OF BAKU

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## OPEN JOINT STOCK COMPANY BANK OF BAKU

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

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Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of Open Joint Stock Company Bank of Baku and its subsidiary (the "Group") 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 consolidated 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 Group's consolidated financial position and financial performance;
- Making an assessment of the Group'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 Group;
- Maintaining adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group 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 Group; and
- Preventing and detecting fraud and other irregularities.

The consolidated financial statements of the Group for the year ended December 31, 2013 were approved by management on April 29, 2014:

On behalf of the Management Board:

Chairman  
Mr. Farid Huseynov

April 29, 2014  
Baku, the Republic of Azerbaijan



Chief Accountant  
Mrs. Rena Efendiyeva

April 29, 2014  
Baku, the Republic of Azerbaijan



## INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Management Board of Open Joint Stock Company Bank of Baku:

We have audited the accompanying consolidated financial statements of Open Joint Stock Company Bank of Baku and its subsidiary (collectively – the "Group"), which comprise the consolidated statement of financial position as at December 31, 2013, and the consolidated statement of profit or loss, consolidated statement of other comprehensive income, consolidated statement of changes in equity and consolidated 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 Consolidated Financial Statements*

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

### *Auditor's Responsibility*

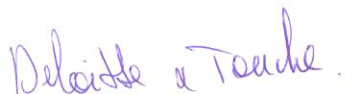
Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable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

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

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

### *Opinion*

In our opinion, the consolidated financial statements of the Group present fairly, in all material respects, the consolidated financial position of the Group 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.



April 29, 2014  
Baku, the Republic of Azerbaijan

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# OPEN JOINT STOCK COMPANY BANK OF BAKU

## CONSOLIDATED STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED DECEMBER 31, 2013

(in thousands of Azerbaijan Manats, except for earnings per share which are in Manats)

	Notes	Year ended December 31, 2013	Year ended December 31, 2012
<b>Interest income</b>			
Interest income on financial assets recorded at amortised cost comprise:			
Loans to customers, excluding finance lease receivables		136,780	94,305
Other debt securities		154	154
Amounts due from banks and other credit institutions		121	97
Finance lease receivables		25	129
Interest income on financial assets at fair value comprise:			
Investment securities available-for-sale		126	105
	24	137,206	94,790
<b>Interest expense</b>			
Interest expense on financial liabilities recorded at amortised cost comprise:			
Amounts due to customers		(38,882)	(27,511)
Amounts due to banks and other financial institutions		(6,055)	(3,575)
Debt securities issued		(1,923)	(57)
Subordinated debt		(406)	(406)
	24	(47,266)	(31,549)
NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS		89,940	63,241
Provision for loan impairment losses	4,24	(8,104)	(5,143)
NET INTEREST INCOME		81,836	58,098
Net fee and commission income	5,24	9,953	6,487
Net gains/(losses) from foreign currencies:			
- dealing		640	431
- translation differences		(1)	37
Provision on other operations		64	-
Other income	6	5,247	2,698
NET NON-INTEREST INCOME		15,903	9,653
Personnel expenses	7,24	(26,562)	(18,745)
Depreciation and amortization	7	(2,203)	(1,685)
Other operating expenses	7,24	(10,127)	(6,556)
Impairment loss on premises	14	-	(138)
NON-INTEREST EXPENSES		(38,892)	(27,124)
PROFIT BEFORE INCOME TAX		58,847	40,627
Income tax expense	8	(12,456)	(8,292)
NET PROFIT FOR THE YEAR		<b>46,391</b>	<b>32,335</b>
EARNINGS PER SHARE (AZN)	22	13.64	9.51

On behalf of the Management Board:

Chairman  
Mr. Farid Huseynov

April 29, 2014  
Baku, the Republic of Azerbaijan



Chief Accountant  
Mrs. Rena Efendiyeva

April 29, 2014  
Baku, the Republic of Azerbaijan

The notes on pages 9-52 form an integral part of these consolidated financial statements.

OPEN JOINT STOCK COMPANY BANK OF BAKU

CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME  
FOR THE YEAR ENDED DECEMBER 31, 2013  
(in thousands of Azerbaijan Manats)

	Notes	Year ended December 31, 2013	Year ended December 31, 2012
NET PROFIT FOR THE PERIOD		46,391	32,335
OTHER COMPREHENSIVE INCOME			
Items that will not be reclassified subsequently to profit or loss:			
Net gain resulting on revaluation of property		-	4,922
Income tax	8	-	(984)
OTHER COMPREHENSIVE INCOME AFTER INCOME TAX		-	3,938
TOTAL COMPREHENSIVE INCOME		46,391	36,273

On behalf of the Management Board:

Chairman  
Mr. Farid Huseynov

April 29, 2014  
Baku, the Republic of Azerbaijan



Chief Accountant  
Mrs. Rena Efendiyeva

April 29, 2014  
Baku, the Republic of Azerbaijan

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# OPEN JOINT STOCK COMPANY BANK OF BAKU

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

	Notes	December 31, 2013	December 31, 2012
<b>ASSETS</b>			
Cash and cash equivalents	9	40,824	27,160
Amounts due from banks and other credit institutions	10	15,685	8,900
Loans to customers	11,24	546,626	407,134
Investment securities available-for-sale	12,24	9,071	18,578
Other debt securities	13	5,017	5,015
Property and equipment	14	18,946	16,703
Intangible assets	15	1,517	1,025
Other assets	16	5,191	1,666
<b>TOTAL ASSETS</b>		<b>642,877</b>	<b>486,181</b>
<b>LIABILITIES AND EQUITY</b>			
<b>LIABILITIES:</b>			
Amounts due to banks and other financial institutions	17	75,893	72,482
Amounts due to customers	18,24	411,931	300,620
Debt securities issued	19	16,332	10,057
Current income tax liabilities		5,874	3,041
Deferred income tax liabilities	8	1,803	1,630
Other liabilities	20,24	5,233	2,756
Subordinated debt	21,24	2,809	2,816
<b>Total liabilities</b>		<b>519,875</b>	<b>393,402</b>
<b>EQUITY:</b>			
Share capital	22	52,870	52,870
Property revaluation reserve		7,604	7,989
Retained earnings		62,528	31,920
<b>Total equity</b>		<b>123,002</b>	<b>92,779</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>642,877</b>	<b>486,181</b>

On behalf of the Management Board:

Chairman  
Mr. Farid Huseynov

April 29, 2014  
Baku, the Republic of Azerbaijan



Chief Accountant  
Mrs. Rena Efendiyeva

April 29, 2014  
Baku, the Republic of Azerbaijan

The notes on pages 9-52 form an integral part of these consolidated financial statements.



**OPEN JOINT STOCK COMPANY BANK OF BAKU**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY  
FOR THE YEAR ENDED DECEMBER 31, 2013**

*(in thousands of Azerbaijan Manats)*

	Notes	Share capital	Property revaluation reserve	Retained earnings	Total Equity
<b>January 1, 2012</b>		<u>26,180</u>	<u>4,424</u>	<u>26,612</u>	<u>57,216</u>
Profit for the year		-	-	32,335	32,335
Depreciation of revaluation reserve		-	(373)	373	-
Other comprehensive income for the year		-	3,938	-	3,938
Capitalization of profit for the year 2011 to share capital	22	26,690	-	(26,690)	-
Dividends declared	22	<u>-</u>	<u>-</u>	<u>(710)</u>	<u>(710)</u>
<b>December 31, 2012</b>		<u>52,870</u>	<u>7,989</u>	<u>31,920</u>	<u>92,779</u>
Profit for the year		-	-	46,391	46,391
Depreciation of revaluation reserve		-	(385)	385	-
Dividends declared	22	<u>-</u>	<u>-</u>	<u>(16,168)</u>	<u>(16,168)</u>
<b>December 31, 2013</b>		<u><b>52,870</b></u>	<u><b>7,604</b></u>	<u><b>62,528</b></u>	<u><b>123,002</b></u>

On behalf of the Management Board:

Chairman  
Mr. Farid Huseynov

April 29, 2014  
Baku, the Republic of Azerbaijan



Chief Accountant  
Mrs. Rena Efendiyeva

April 29, 2014  
Baku, the Republic of Azerbaijan

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The notes on pages 9-52 form an integral part of these consolidated financial statements.

# OPEN JOINT STOCK COMPANY BANK OF BAKU

## CONSOLIDATED 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
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Interest received		134,132	102,070
Interest paid		(39,338)	(25,843)
Fees and commissions received		12,154	7,383
Fees and commissions paid		(2,201)	(1,223)
Net realized gains from dealing in foreign currencies		640	431
Other income received		5,247	2,639
Personnel expenses paid		(26,972)	(18,727)
Other operating expenses paid		(9,772)	(6,699)
Cash flows from operating activities before changes in operating assets and liabilities		73,890	60,031
<i>Net increase in operating assets</i>			
Amounts due from banks and other credit institutions		(6,830)	(3,337)
Loans to customers		(143,542)	(161,379)
Other assets		(1,875)	(186)
<i>Net increase/(decrease) in operating liabilities</i>			
Amounts due to banks and other financial institutions		2,813	34,297
Amounts due to customers		104,229	88,977
Other liabilities		70	(12)
Net cash inflow from operating activities before income tax		28,755	18,391
Income tax paid		(9,450)	(5,399)
Net cash inflow from operating activities		19,305	12,992
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of investment securities available-for-sale		(131,847)	(88,943)
Proceeds from sale and redemption of investment securities available-for-sale		141,344	79,143
Purchase of property and equipment		(6,138)	(2,806)
Proceeds from sale of property and equipment		9	11
Acquisition of intangible assets	15	(606)	(824)
Net cash inflow/(outflow) from investing activities		2,762	(13,419)

## OPEN JOINT STOCK COMPANY BANK OF BAKU

### CONSOLIDATED 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
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from debt securities issued		5,950	10,000
Dividends paid		(14,536)	(639)
Net cash (outflow)/ inflow from financing activities		(8,586)	9,361
Effect of exchange rate changes on the balance of cash and cash equivalents held in foreign currencies		183	250
NET INCREASE IN CASH AND CASH EQUIVALENTS		13,664	9,184
CASH AND CASH EQUIVALENTS, beginning of the year	9	27,160	17,976
CASH AND CASH EQUIVALENTS, end of the year	9	<b>40,824</b>	<b>27,160</b>

#### Significant non-cash financing transaction

Reposessed collaterals amounted to AZN 450 thousand and AZN 180 thousand during the year ended December 31, 2013 and December 31, 2012, respectively.

There were no non-cash transactions performed by the Group during 2013 (2012 – capitalization of its 2011 profit to share capital for AZN 26,690 thousand).

On behalf of the Management Board:

Chairman  
Mr. Farid Huseynov



April 29, 2014  
Baku, the Republic of Azerbaijan

Chief Accountant  
Mrs. Rena Efendiyeva

April 29, 2014  
Baku, the Republic of Azerbaijan

The notes on pages 9-52 form an integral part of these consolidated financial statements.



# OPEN JOINT STOCK COMPANY BANK OF BAKU

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2013

(in thousands of Azerbaijan Manats, unless otherwise indicated)

### 1. ORGANIZATION

OJSC Bank of Baku is the parent company of the Group. On February 18, 2005, Open Joint Stock Commercial Bank "Bank of Baku" and Closed Joint Stock Commercial Bank "Ilkbank" combined and formed a new bank under the name Open Joint Stock Commercial Bank "Bank of Baku" (the "Bank"). The Bank operates under banking license number 247 issued by the Central Bank of the Republic of Azerbaijan (the "CBAR") on February 18, 2005. The Bank changed its name from Open Joint Stock Commercial Bank "Bank of Baku" to Open Joint Stock Company "Bank of Baku" on May 15, 2006.

The Bank accepts deposits from the public and extends credit, transfers payments in the Republic of Azerbaijan and abroad, exchanges currencies and provides other banking services to its commercial and retail customers. Its main office is in Baku and it has 22 branches (2012: 17) in Baku and other cities of the Republic of Azerbaijan and 1 servicing outlet as at December 31, 2013 (2012: 1 servicing outlet). The Bank's registered legal address is 42 Ataturk Avenue, Baku, AZ 1069, Azerbaijan.

Starting from July 30, 2007, the Bank has been a member of the deposit insurance system. The system operates under the Law on Deposit Insurance and other regulations and is governed by the Azerbaijan Deposit Insurance Fund. Insurance covers the Bank's liabilities to individual depositors for the amount up to AZN 30 thousand with maximum interest rate of 10% for each individual in case of business failure and revocation of the CBAR banking license.

The Bank is a parent company of a banking group (the "Group") which consists of the following enterprises consolidated in these financial statements:

Name	Country of operation	Proportion or ownership interest/voting rights (%)		Type of operation
		2013	2012	
Bank of Baku OJSC	The Republic of Azerbaijan	Parent		Banking
BOB Broker Ltd.	The Republic of Azerbaijan	100		Broker services

"BOB Broker" Ltd. (the "Subsidiary") is a wholly-owned subsidiary of the Bank and is consolidated in the financial statements of the Bank. The Subsidiary was formed as a limited liability company under the laws of the Republic of Azerbaijan on February 28, 2007. It is principally engaged in brokerage of securities in the Azerbaijan stock market. It possesses a license for operations with securities from the State Securities Committee of the Republic of Azerbaijan dated May 15, 2007.

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

Shareholder	December 31, 2013, %	December 31, 2012, %
NAB Holding	40.00	40.00
Azpetrol Neft Shirketi LLC	28.89	28.89
Mr. Rafiq Aliyev	11.22	11.22
Mr. Elchin Isayev	10.00	10.00
Azinvest LLC	9.89	9.89
<b>Total</b>	<b>100.00</b>	<b>100.00</b>

NAB Holding is ultimately controlled by Nader Mohaghegh Oromi, Bahram Mohaghegh Oromi and Shahram Mohaghegh Oromi. The ultimate shareholder of Azpetrol Neft Shirketi LLC is Mr. Ibrahim Mammadov; of Azinvest LLC is Mr. Rafiq Aliyev. Mr. Aliyev, who owns 21.11% (11.22% of direct ownership and 9.89% through Azinvest LLC) of the share capital of the Bank.

These consolidated financial statements were authorized for issue on April 29, 2014 by the Management Board.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### Statement of Compliance

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

These consolidated financial statements have been prepared on the assumption that the Group is a going concern and will continue in operation for the foreseeable future.

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

These consolidated financial statements have been prepared on the historical cost basis except for buildings and certain financial instruments that are measured at revalued amounts or fair values at the end of each reporting period, as explained in the accounting policies below.

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

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 Group 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 consolidated financial statements is determined on such a basis, except for share-based payment transactions that are within the scope of IFRS 2, 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 net realisable value in IAS 2 or 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 and its consolidated company, registered in the Republic of Azerbaijan, maintain their accounting records in accordance with local accounting practice. These consolidated financial statements have been prepared from the statutory accounting records and have been adjusted to conform to IFRS.

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

### **Functional currency**

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary of the economic environment in which the entity operates ("the functional currency"). The functional currency of the parent of the Group is the Azerbaijan Manats ("AZN"). The presentational currency of the consolidated financial statements of the Group is AZN. All values are rounded to the nearest thousand Manats, 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 consolidated statement of profit or loss unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

The principal accounting policies are set out below.

## Basis of consolidation

These consolidated financial statements incorporate the financial statements of the Bank and its subsidiary. Control is achieved when the Bank:

- has power over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect its returns.

The Bank reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

When the Bank has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Bank considers all relevant facts and circumstances in assessing whether or not the Bank's voting rights in an investee are sufficient to give it power, including:

- the size of the Bank's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- potential voting rights held by the Bank, other vote holders or other parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate that the Bank has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

All intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.



## **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 Group and the amount of income can be measured reliably. Interest income and expense are recognised 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.

### Recognition of dividend income

Dividend income from investments is recognized when the shareholder's right to receive payment has been established (provided that it is probable that the economic benefits will flow to the Group and the amount of income can be measured reliably).

## **Financial instruments**

The Group recognizes financial assets and liabilities in its consolidated 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 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 of the Group 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 (AFS) financial assets are non-derivatives that are either designated as available-for-sale or are not classified as loans and receivables, held to maturity investments or financial assets at fair value through profit or loss.

Notes of the CBAR held by the Group that are traded in an active market are classified as AFS and are stated at fair value. Gains and losses arising from changes in fair value are recognised in other comprehensive income and accumulated in the investments revaluation reserve, with the exception of other-than-temporary impairment losses, interest calculated using the effective interest method, dividend income and foreign exchange gains and losses on monetary assets, which are recognised in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.

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***

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market (including balances with the CBAR, amount due from banks and other credit institutions, 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.

### ***Other debt securities***

This classification includes unquoted non-derivative financial assets with fixed or determinable payments and fixed maturities. Management determines the classification of other debt securities at their initial recognition and reassesses the appropriateness of that classification at the end of each reporting period. Other debt securities are carried at amortised cost and are classified as loans and receivables category under IAS 39.

### ***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 Group'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 investments 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 Group 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 Group and after the Group 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 consolidated statement of profit or loss 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 Group 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 Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group 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 Group retains an option to repurchase part of a transferred asset), the Group 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**

### Classification as debt or equity

Debt and equity instruments 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.

### Equity instrument

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 Group are recognized at the proceeds received, net of direct issue costs.

### Financial liabilities

Financial liabilities are classified as 'other financial liabilities'

### ***Other financial liabilities***

Other financial liabilities, including amounts due to banks and other financial institutions, amounts due to customers, other liabilities and subordinated debt, 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 Group 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 Group derecognises financial liabilities when, and only when, the Group'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 Group 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.

#### ***The Group as lessor***

Amounts due from lessees under finance leases are recognised as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases.

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

### **Cash and cash equivalents**

Cash and cash equivalents include cash on hand, amounts due from the CBAR excluding obligatory reserves, and amounts due from banks and other credit institutions with original maturity of less or equal to 90 days and are free from contractual encumbrances.

### **Minimum reserve deposits with the CBAR**

Minimum reserve deposits with the CBAR represent the amount of obligatory reserves deposited with the CBAR which are not available to finance the Group's day-to-day operations and hence are not considered as part of cash and cash equivalents for the purposes of the consolidated 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**

Land and buildings are stated in the consolidated statement of financial position at their revalued amounts, being the fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amounts do not differ materially from those that would be determined using fair values at the end of each reporting period.



Any revaluation increase arising on the revaluation of buildings is recognised in other comprehensive income and accumulated in equity, except to the extent that it reverses a revaluation decrease for the same asset previously recognised in profit or loss, in which case the increase is credited to profit or loss to the extent of the decrease previously expensed. A decrease in the carrying amount arising on the revaluation of buildings is recognised in profit or loss to the extent that it exceeds the balance, if any, held in the properties revaluation reserve relating to a previous revaluation of that asset.

Construction in progress is carried at cost, less any recognised impairment loss. Such construction in progress is classified to the appropriate categories of property and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

Depreciation on revalued buildings is recognised in profit or loss. On the subsequent sale or retirement of a revalued property, the attributable revaluation surplus remaining in the properties revaluation reserve is transferred directly to retained earnings.

Freehold land is not depreciated.

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

Depreciation is recognised so as to write-off the cost or valuation of assets (other than freehold land and properties under construction) 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%
Computers and communication equipment	25%
Vehicles	20%
Other	20%

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. Intangible assets are amortized over 10 years useful life.

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, and 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 Group 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). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where 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, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

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, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

## **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 differs from profit as reported in the consolidated statement of profit or loss because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Group's liability for 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 consolidated 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 assets and liabilities 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 Group 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**

The Republic of Azerbaijan also has various other taxes, which are assessed on the Group's activities. These taxes are included as a component of operating expenses in the consolidated statement of comprehensive income.

**Provisions**

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group 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 (where 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 consolidated 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 consolidated statement of financial position but disclosed when an inflow of economic benefits is probable.

**Foreign currencies**

In preparing the financial statements of each individual group entity, transactions in currencies other than the entity'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.

The exchange rates used by the Group in the preparation of the consolidated 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

**Retirement benefit costs**

Payments to defined contribution retirement benefit plans are recognised as an expense when employees have rendered service entitling them to the contributions.

**Collateral**

The Group 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 Group a claim on these assets for both existing and future customer liabilities.



## **Equity reserves**

The reserve recorded in equity on the Group's consolidated statement of financial position includes revaluation reserves which comprise change in fair value of buildings.

## **Segment Reporting**

The Group's operations are in the Republic of Azerbaijan and constitute a single industry segment - commercial banking. Accordingly for purposes of IFRS 8 "Operating Segments" the Bank is treated as one operating segment.

## **Critical accounting judgments and key sources of estimation uncertainty**

In the application of the Group's accounting policies the directors are required to make judgments, 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 Group regularly reviews its loans and receivables to assess for impairment. The Group's loan impairment provisions are established to recognize incurred impairment losses in its portfolio of loans and receivables. The Group 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 Group's estimated losses and actual losses would require the Group to record provisions which could have a material impact on its financial statements in future periods.

The Group 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 Group 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 Group 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 consolidated financial statements have been determined on the basis of existing economic and political conditions. The Group 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 the gross loans to customers totaled AZN 564,884 thousand and AZN 419,096 thousand, respectively, and allowance for impairment losses amounted to AZN 18,258 thousand and AZN 11,962 thousand, respectively.



### ***Loans from government agencies***

Management has assessed the nature of the agreements with the National Fund for Entrepreneurship Support and Azerbaijan Mortgage Fund, and in particular whether the Bank is acting as an agent of the Government agencies, or as a principal with the borrower under this program. Having considered the risks and rewards related to the loans issued under those programs, management have concluded that the Bank is acting as a principal and accordingly the accounting in these financial statements follows this judgment. Had an alternative conclusion been reached, the gross amounts of loans to customers and due to the Government agencies, of AZN 17,633 thousand and AZN 11,863 thousand as at December 31, 2013 and 2012, respectively, would have been excluded from the Bank's financial statements.

### ***Valuation of financial instruments***

As described in Note 25, the Group 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 Group management believes that the chosen valuation techniques and assumptions used are appropriate in determining the fair value of financial instruments.

### ***Property and equipment carried at revalued amounts***

Certain property (buildings) is measured at revalued amounts. The latest full scope appraisal was as of December 31, 2012. The carrying value of revalued property amounted to AZN 14,201 thousand and AZN 11,819 thousand as at December 31, 2013 and 2012, respectively.

## **3. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)**

In the current year, the following new and revised Standards and Interpretations have been adopted and have affected the amounts reported in these consolidated financial statements.

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.

In the current year, the Group has applied for the first time IFRS 10, IFRS 11, IFRS 12 and IAS 28 (as revised in 2011) together with the amendments to IFRS 10, IFRS 11 and IFRS 12 regarding the transitional guidance. IAS 27 (as revised in 2011) is not applicable to the Group as it deals only with separate financial statements.

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.

The management of the Group has assessed the adoption of IFRS 10 and concluded that it did not result in any change in the composition of 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.

The management of the Group has assessed the adoption of IFRS 11 and concluded that it did not result in any changes as there were no such investments classified as jointly controlled entity under IAS 31.

### **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 do not result in significant impact on disclosures in the consolidated financial statements.

### **Amendments to IFRS 7 “Financial instruments: Disclosures”**

The Group 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 Group has applied the amendments to IAS 1 titled Presentation of Items of Other Comprehensive Income. 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.



## **IAS 19 “Employee Benefits” (revised June 2011)**

In the current year, the Group has applied IAS 19 (as revised in June 2011) Employee Benefits. The amendments to IAS 19 change the accounting for defined benefit schemes and termination benefits. The most significant change relates to the accounting for changes in defined benefit obligations and scheme assets. The application of IAS 19 (June 2011) had no significant impact, as the Group has no defined benefit plans.

## **IFRS 13 “Fair Value Measurement”**

The Group 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 in specified circumstances.

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.

Other than the additional disclosures, the application of IFRS 13 has not had any material impact on the amounts recognised in the consolidated 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 Group 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.

## **Amendments to IFRS 7 “Disclosures—Offsetting Financial Assets and Financial Liabilities”**

IAS 32 Financial Instruments: Presentation requires offsetting of financial assets and financial liabilities when certain criteria are met. The amendments to IFRS 7 require entities to disclose information about rights of offset and related arrangements (such as collateral posting requirements) for financial instruments under an enforceable master netting agreement or similar arrangement.

## **New and revised IFRSs in issue but not yet effective**

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

IFRS 9 “Financial Instruments”

Amendments to IFRS9 and IFRS7 “Mandatory Effective Date of IFRS 9 and Transition Disclosures”<sup>2</sup>

Amendments to IFRS 10, IFRS 12 and IAS 27 “Investment Entities”<sup>1</sup>

Amendments to IAS 32 “Offsetting Financial Assets and Financial Liabilities”<sup>1</sup>

Amendments to IAS 36 “Impairment of Assets”<sup>1</sup>

Amendments to IAS 39 “Financial Instruments: Recognition and Measurement”<sup>1</sup>

Amendments to IFRIC 21 “Levies”<sup>1</sup>

<sup>1</sup> Effective for annual periods beginning on or after January 1, 2014, with earlier application permitted.

<sup>2</sup> 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.
- hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

IFRS 9 is effective starting from January 2018.

The management of the Group anticipate that the application of IFRS 9 in the future may have a significant impact on amounts reported in respect of the Group's financial assets and financial liabilities. 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 consolidated and separate 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 Group does not anticipate that the investment entities amendments will have any effect on the Group's consolidated 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 Group does not anticipate that the application of these amendments to IAS 32 will have a significant impact on the Group's consolidated financial statements as the Group does not have any financial assets and financial liabilities that qualify for offset.

**Annual Improvements to IFRSs 2013 (issued in December 2013 and effective for annual periods beginning on or after July 1, 2014).** The improvements consist of changes to four standards.

- The basis for conclusions on IFRS 1 is amended to clarify that, where a new version of a standard is not yet mandatory but is available for early adoption; a first-time adopter can use either the old or the new version, provided the same standard is applied in all periods presented.
- IFRS 3 was amended to clarify that it does not apply to the accounting for the formation of any joint arrangement under IFRS 11. The amendment also clarifies that the scope exemption only applies in the financial statements of the joint arrangement itself.
- The amendment of IFRS 13 clarifies that the portfolio exception in IFRS 13, which allows an entity to measure the fair value of a group of financial assets and financial liabilities on a net basis, applies to all contracts (including contracts to buy or sell non-financial items) that are within the scope of IAS 39 or IFRS 9.
- IAS 40 was amended to clarify that IAS 40 and IFRS 3 are not mutually exclusive. The guidance in IAS 40 assists preparers to distinguish between investment property and owner-occupied property. Preparers also need to refer to the guidance in IFRS 3 to determine whether the acquisition of an investment property is a business combination.

### **Amendments to IAS 36**

Amendments to IAS 36 “Impairment of Assets” reduce the circumstances in which the recoverable amount of assets or cash-generating units is required to be disclosed, clarify the disclosures required, and introduce an explicit requirement to disclose the discount rate used in determining impairment (or reversals) where recoverable amount (based on fair value less costs of disposal) is determined using a present value technique.

### **Amendments to IFRIC 21 Levies**

Amendments to IFRIC 21 Levies provide guidance on when to recognise a liability for a levy imposed by a government, both for levies that are accounted for in accordance with IAS 37 “Provisions, Contingent Liabilities and Contingent Assets” and those where the timing and amount of the levy is certain.

The Interpretation identifies the obligating event for the recognition of a liability as the activity that triggers the payment of the levy in accordance with the relevant legislation. It provides the following guidance on recognition of a liability to pay levies:

- The liability is recognised progressively if the obligating event occurs over a period of time
- If an obligation is triggered on reaching a minimum threshold, the liability is recognised when that minimum threshold is reached.

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Group's consolidated financial statements.



#### 4. ALLOWANCE FOR IMPAIRMENT LOSSES

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

	Loans to customers
<b>December 31, 2011</b>	8,094
Additional provisions recognized	5,143
Write-off of assets	(1,711)
Recoveries of assets previously written off	436
<b>December 31, 2012</b>	11,962
Additional provisions recognized	8,104
Write-off of assets	(2,318)
Recoveries of assets previously written off	510
<b>December 31, 2013</b>	<b>18,258</b>

#### 5. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	Year ended December 31, 2013	Year ended December 31, 2012
<b>Fee and commission income:</b>		
Cash operations	6,037	4,854
Plastic card operations	4,453	323
Currency conversion operations	665	489
Guarantee letters	611	376
Settlements	306	253
Letters of credit	-	1,287
Other operations	82	128
<b>Total fee and commission income</b>	<b>12,154</b>	<b>7,710</b>
<b>Fee and commission expense:</b>		
Plastic card operations	(988)	(654)
Settlements	(847)	(437)
Letters of credit	(362)	(119)
Cash operations	(4)	(13)
<b>Total fee and commission expense</b>	<b>(2,201)</b>	<b>(1,223)</b>
<b>Total net fee and commission income</b>	<b>9,953</b>	<b>6,487</b>

#### 6. OTHER INCOME

Other income comprises:

	Year ended December 31, 2013	Year ended December 31, 2012
Fines and penalties received in relation to loans to customers	5,233	2,665
Dividend income	-	6
Other	14	27
<b>Total other income</b>	<b>5,247</b>	<b>2,698</b>

## 7. OPERATING EXPENSES

Operating expenses comprise:

	Year ended December 31, 2013	Year ended December 31, 2012
Salaries and bonuses	22,944	15,958
Social security costs	3,340	2,612
Other employment expenses	278	175
<b>Personnel expenses</b>	<b>26,562</b>	<b>18,745</b>
Depreciation charge	2,089	1,596
Amortization charge	114	89
<b>Depreciation and amortization charge</b>	<b>2,203</b>	<b>1,685</b>
Marketing and advertising	3,366	1,722
Occupancy and rent	1,749	1,597
Deposit insurance fee	1,019	555
Taxes other than income tax	619	144
Legal and consultancy	587	349
Repair and maintenance of property and equipment	572	528
Office supplies	461	425
Security	447	380
Communications	278	193
Printing	252	166
Utilities	169	127
Business travel and related expenses	86	76
Insurance	71	65
Vehicle running costs	61	40
Membership fees	13	17
Other expense	377	172
<b>Other operating expenses</b>	<b>10,127</b>	<b>6,556</b>

## 8. INCOME TAXES

The Group 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 Group and its subsidiary operate, which may differ from IFRS.

The Group 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% (2012: 20%) payable by corporate entities in the Republic of Azerbaijan on taxable profits (as defined) under tax law in that jurisdiction.



Temporary differences as at December 31, 2013 and 2012 comprise:

	December 31, 2013	December 31, 2012
<b>Tax effect of deductible temporary differences:</b>		
Loans to customers	317	196
Other liabilities	(71)	-
<b>Deferred tax assets</b>	<b>246</b>	<b>196</b>
<b>Tax effect of taxable temporary differences:</b>		
Property and equipment	(2,049)	(1,826)
<b>Deferred tax liabilities</b>	<b>(2,049)</b>	<b>(1,826)</b>
<b>Net deferred tax liability</b>	<b>(1,803)</b>	<b>(1,630)</b>

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

	Year ended December 31, 2013	Year ended December 31, 2012
Profit before income tax	58,847	40,627
Tax at the statutory tax rate 20% (2012: 20%)	(11,769)	(8,125)
Under/(over) provision of income tax in prior years	219	(79)
Non-deductible expenses	(906)	(88)
<b>Income tax expense</b>	<b>(12,456)</b>	<b>(8,292)</b>
Current income tax expense	(12,283)	(8,354)
Change in deferred tax liabilities	(173)	62
<b>Income tax expense</b>	<b>(12,456)</b>	<b>(8,292)</b>
<b>Deferred tax liabilities</b>	<b>2013</b>	<b>2012</b>
<b>As at January 1 – deferred tax liabilities</b>	<b>(1,630)</b>	<b>(708)</b>
Change in deferred income tax balances recognized in other comprehensive income	-	(984)
Change in deferred income tax balances recognized in consolidated profit or loss	(173)	62
<b>As at December 31 – deferred tax liabilities</b>	<b>(1,803)</b>	<b>(1,630)</b>

## 9. CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise:

	December 31, 2013	December 31, 2012
Cash on hand	21,152	15,900
Current accounts with the CBAR	2,462	3,620
Current accounts with other credit institutions	17,210	7,640
<b>Total cash and cash equivalents</b>	<b>40,824</b>	<b>27,160</b>

As of December 31, 2013, current accounts with other credit institutions included AZN 16,247 thousand placed with two internationally recognized Organization for Economic Cooperation and Development ("OECD") banks (2012 – AZN 4,529 thousand placed with two internationally recognized OECD banks).

As of December 31, 2013, current accounts with other credit institutions included AZN 289 thousand placed with two Azerbaijani banks (2012 – AZN 2,548 thousand placed with three Azerbaijani banks).

#### 10. AMOUNTS DUE FROM BANKS AND OTHER CREDIT INSTITUTIONS

Due from banks and other credit institutions comprise:

	December 31, 2013	December 31, 2012
Obligatory reserve with the CBAR	12,338	8,294
Loans to credit institutions	1,500	256
Time deposits for more than 90 days	1,500	3
Blocked accounts	347	347
<b>Total amounts due from banks and other credit institutions</b>	<b>15,685</b>	<b>8,900</b>

Credit institutions in Azerbaijan are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR, the amount of which depends on the level of funds attracted by the credit institution. The Bank's ability to withdraw such deposit is significantly restricted by the statutory legislation.

Blocked accounts represent security deposits in the amount of AZN 347 thousand placed to secure settlement operations through MasterCard International (2012 - AZN 347 thousand).

#### 11. LOANS TO CUSTOMERS

Loans to customers comprise:

	December 31, 2013	December 31, 2012
Loans to customers	564,884	419,096
Less: allowance for impairment losses	(18,258)	(11,962)
<b>Total loans to customers</b>	<b>546,626</b>	<b>407,134</b>

Movements in the allowance for impairment losses for the years ended December 31, 2013 and 2012 are disclosed in Note 4.

Loans have been extended to the following types of customers:

	December 31, 2013	December 31, 2012
Individuals	542,135	385,689
Private companies	22,749	33,407
<b>Gross loans to customers</b>	<b>564,884</b>	<b>419,096</b>



The table below summarizes carrying value of loans to customers analyzed by industry sector:

	December 31, 2013	December 31, 2012
<b>Analysis by sector:</b>		
Individuals	542,135	385,689
Trade and services	15,417	17,978
Agriculture and food processing	6,769	7,640
Manufacturing	555	7,701
Real estate construction	8	88
	<u>564,884</u>	<u>419,096</u>
Less: allowance for impairment losses	<u>(18,258)</u>	<u>(11,962)</u>
<b>Total loans to customers</b>	<b><u>546,626</u></b>	<b><u>407,134</u></b>

Loans to customers comprise the following products:

	December 31, 2013	December 31, 2012
Consumer loans	280,588	217,634
Cards	100,613	29,272
Auto loans	99,604	93,893
Microloans	58,715	32,942
Business loans	<u>25,364</u>	<u>45,355</u>
	<u>564,884</u>	<u>419,096</u>
Less: allowance for impairment losses	<u>(18,258)</u>	<u>(11,962)</u>
<b>Total loans to customers</b>	<b><u>546,626</u></b>	<b><u>407,134</u></b>

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

The table below summarizes an analysis of loans to customers by impairment:

	December 31, 2013			December 31, 2012		
	Carrying value before allowance	Allowance for impairment losses	Carrying value	Carrying value before allowance	Allowance for impairment losses	Carrying value
Loans to customers collectively assessed for impairment:						
Auto loans	99,604	(4,133)	95,471	93,893	(2,679)	91,214
Business loans	16,944	(437)	16,507	37,163	(881)	36,282
Consumer loans	280,588	(9,761)	270,827	217,634	(5,711)	211,923
Microloans	58,715	(487)	58,228	32,942	(482)	32,460
Cards	100,613	(2,611)	98,002	29,272	(389)	28,883
	<u>556,464</u>	<u>(17,429)</u>	<u>539,035</u>	<u>410,904</u>	<u>(10,142)</u>	<u>400,762</u>
Loans to customers individually assessed for impairment:						
Business loans	<u>8,420</u>	<u>(829)</u>	<u>7,591</u>	<u>8,192</u>	<u>(1,820)</u>	<u>6,372</u>
<b>Total</b>	<b><u>564,884</u></b>	<b><u>(18,258)</u></b>	<b><u>546,626</u></b>	<b><u>419,096</u></b>	<b><u>(11,962)</u></b>	<b><u>407,134</u></b>

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended December 31, 2013, amounted to AZN 58 thousand (2012 – AZN 193 thousand).

The fair value of collateral that the Group holds relating to loans individually determined to be impaired at December 31, 2013 amounts to AZN 2,447 thousand (2012 – AZN 2,452 thousand).

During the years ended December 31, 2013 and 2012 the Group 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 450 thousand and AZN 180 thousand, respectively, are included in other assets. It is the Group's policy to dispose repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for business use.

#### Finance lease receivables

Corporate lending portfolio includes finance lease receivables. The analysis of finance lease receivables as at December 31, 2013 is as follows:

	Not later than 1 year	Later than 1 year and not later than 5 years	Later than 5 years	Total
Gross investment in finance leases	29	190	-	219
Unearned future finance income on finance leases	(9)	(112)	-	(121)
<b>Net investment in finance leases</b>	<b>20</b>	<b>78</b>	<b>-</b>	<b>98</b>

The analysis of finance lease receivables as at December 31, 2012 is as follows:

	Not later than 1 year	Later than 1 year and not later than 5 years	Later than 5 years	Total
Gross investment in finance leases	273	157	356	786
Unearned future finance income on finance leases	(16)	(57)	(221)	(294)
<b>Net investment in finance leases</b>	<b>257</b>	<b>100</b>	<b>135</b>	<b>492</b>

## 12. INVESTMENT SECURITIES AVAILABLE-FOR-SALE

Investment securities available-for-sale comprises:

	December 31, 2013	December 31, 2012
Debt securities	7,490	16,992
Equity investments	1,581	1,586
<b>Total investment securities available-for-sale</b>	<b>9,071</b>	<b>18,578</b>

	Nominal interest rate	December 31, 2013	Nominal interest rate	December 31, 2012
<b>Debt securities</b>				
Notes issued by the Central Bank of the Republic of Azerbaijan	0%	7,490	1.20% - 2.51%	16,992
<b>Total debt securities</b>		<b>7,490</b>		<b>16,992</b>



Equity investments	Ownership	December 31, 2013	Ownership	December 31, 2012
Buta Insurance OJSC	19.0%	1,387	19.0%	1,387
International Bank of Azerbaijan OJSC	0.2%	94	0.2%	99
Baku Stock Exchange LLC	5.0%	60	5.0%	60
"MilliKart" LLC	0.8%	40	0.8%	40
<b>Total investment securities available-for-sale</b>		<b>1,581</b>		<b>1,586</b>

### 13. OTHER DEBT SECURITIES

Other debt securities comprise:

	Nominal interest rate	December 31, 2013	Nominal interest rate	December 31, 2012
Long-term notes issued by the Azerbaijan Mortgage Fund	3.00% - 3.15%	5,017	3.00% - 3.15%	5,015
<b>Total other debt securities</b>		<b>5,017</b>		<b>5,015</b>

### 14. PROPERTY AND EQUIPMENT

Property and equipment comprise:

	Land and buildings	Furniture and equipment	Computers and communication equipment	Vehicles	Other	Construction in progress	Total
<b>At initial/ revalued cost</b>							
December 31, 2011	11,694	2,716	2,482	543	115	402	17,952
Revaluation	(459)	-	-	-	-	-	(459)
Additions	769	1,400	608	184	87	810	3,858
Disposals	(16)	(94)	(111)	(51)	(9)	-	(281)
December 31, 2012	11,988	4,022	2,979	676	193	1,212	21,070
Additions	1,863	1,014	1,222	185	53	-	4,337
Transfers	1,212	-	-	-	-	(1,212)	-
Disposals	-	(94)	(6)	-	(1)	-	(101)
<b>December 31, 2013</b>	<b>15,063</b>	<b>4,942</b>	<b>4,195</b>	<b>861</b>	<b>245</b>	<b>-</b>	<b>25,306</b>
<b>Accumulated depreciation</b>							
December 31, 2011	(4,658)	(1,651)	(1,662)	(279)	(18)	-	(8,268)
Eliminated on revaluation	5,243	-	-	-	-	-	5,243
Depreciation charge	(597)	(471)	(388)	(111)	(29)	-	(1,596)
Eliminated on disposal	12	104	104	32	2	-	254
December 31, 2012	-	(2,018)	(1,946)	(358)	(45)	-	(4,367)
Depreciation charge	(693)	(651)	(571)	(131)	(43)	-	(2,089)
Eliminated on disposal	-	90	6	-	-	-	96
<b>December 31, 2013</b>	<b>(693)</b>	<b>(2,579)</b>	<b>(2,511)</b>	<b>(489)</b>	<b>(88)</b>	<b>-</b>	<b>(6,360)</b>
<b>Net book value</b>							
<b>As at December 31, 2013</b>	<b>14,370</b>	<b>2,363</b>	<b>1,684</b>	<b>372</b>	<b>157</b>	<b>-</b>	<b>18,946</b>
<b>As at December 31, 2012</b>	<b>11,988</b>	<b>2,004</b>	<b>1,033</b>	<b>318</b>	<b>148</b>	<b>1,212</b>	<b>16,703</b>

As at December 31, 2013 and 2012 included in property and equipment were fully depreciated assets of AZN 2,415 thousand and AZN 1,728 thousand, respectively.

Land and buildings owned by the Group were revalued by an independent appraiser as at December 31, 2012. The following methods were used for the estimation of their fair value: discounted cash flow method (income approach), integrated cost estimation method (cost based method), method of sales comparison (comparative approach). For the estimation of the final value, certain weights were assigned to the results obtained using different approaches, depending on the degree to which the estimates met the following characteristics: reliability and completeness of the information, specifies the estimated property and other.

If the buildings were measured using the cost model, the carrying amounts would be as follows:

	December 31, 2013	December 31, 2012
Cost	6,155	4,292
Accumulated depreciation	<u>(1,068)</u>	<u>(760)</u>
<b>Net carrying amount</b>	<b><u>5,087</u></b>	<b><u>3,532</u></b>

Details of the Group's buildings and information about the fair value hierarchy as at December 31, 2013 are as follows:

	Level 2	Fair value as at December 31, 2013
Buildings	<u>14,201</u>	<u>14,201</u>
<b>Total</b>	<b><u>14,201</u></b>	<b><u>14,201</u></b>

## 15. INTANGIBLE ASSETS

Intangible assets comprise:

	Licenses	Computer software	Total
<b>At cost</b>			
December 31, 2011	175	376	551
Additions	<u>280</u>	<u>544</u>	<u>824</u>
December 31, 2012	455	920	1,375
Additions	<u>3</u>	<u>603</u>	<u>606</u>
December 31, 2013	458	1,523	1,981
<b>Accumulated amortization</b>			
December 31, 2011	(83)	(178)	(261)
Charge for the year	<u>(26)</u>	<u>(63)</u>	<u>(89)</u>
December 31, 2012	(109)	(241)	(350)
Charge for the year	<u>(14)</u>	<u>(100)</u>	<u>(114)</u>
December 31, 2013	<u>(123)</u>	<u>(341)</u>	<u>(464)</u>
<b>Net book value</b>			
<b>December 31, 2013</b>	<b><u>335</u></b>	<b><u>1,182</u></b>	<b><u>1,517</u></b>
<b>December 31, 2012</b>	<b><u>346</u></b>	<b><u>679</u></b>	<b><u>1,025</u></b>



## 16. OTHER ASSETS

Other assets comprise:

	December 31, 2013	December 31, 2012
<b>Other financial assets:</b>		
Settlements on money transfers	1,470	331
	<u>1,470</u>	<u>331</u>
<b>Other non-financial assets:</b>		
Prepayments for the purchase of property and equipment	2,425	619
Deferred expenses	927	515
Properties received in satisfaction of non-performing loans	450	180
Receivables from state and local funds	105	77
Other	21	7
	<u>3,928</u>	<u>1,398</u>
Less: allowance for impairment losses	(207)	(63)
	<u>3,721</u>	<u>1,335</u>
<b>Total other assets</b>	<b><u>5,191</u></b>	<b><u>1,666</u></b>

## 17. AMOUNTS DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

Amounts due to banks and other financial institutions comprise:

	December 31, 2013	December 31, 2012
Time deposits	49,754	54,179
Loans from financial institutions	24,861	17,047
Demand deposits	<u>1,278</u>	<u>1,256</u>
<b>Total amounts due to banks and other financial institutions</b>	<b><u>75,893</u></b>	<b><u>72,482</u></b>

As at December 31, 2013, time deposits and loans from financial institutions included balances of AZN 14,561 thousand (2012 – AZN 9,126 thousand) due to four (2012 - four) OECD and non-OECD financial institutions.

As at December 31, 2013, demand deposits included balances of AZN 1,062 thousand (2012 – AZN 806 thousand) due to two (2012 - three) Azerbaijani financial institutions.

Demand and time deposits include accounts with the following types of institutions:

	December 31, 2013	December 31, 2012
Insurance companies	33,254	27,492
Commercial banks	10,349	16,360
Investment companies	7,160	8,234
Other financial institutions	<u>269</u>	<u>3,349</u>
<b>Demand and time deposits</b>	<b><u>51,032</u></b>	<b><u>55,435</u></b>

As at December 31, 2013, time deposits were due to financial institutions with effective annual interest rates of 2.40% - 13.00% (AZN, USD, EUR), (2012 – 5.0%-16.0% (AZN, USD, EUR)) and maturity in 2014-2023 (2012: in 2013-2016).

Loans from financial institutions include accounts with the following types of institutions:

	December 31, 2013	December 31, 2012
The National Fund for Entrepreneurship Support	12,393	9,087
The Azerbaijan Mortgage Fund	5,240	2,776
Commercial banks	3,000	1,006
German Azerbaijan Fund	2,241	2,187
GFM Cossack Bond Company Limited	1,987	1,991
<b>Loans from financial institutions</b>	<b>24,861</b>	<b>17,047</b>

The Group is obligated to comply with financial covenants in relation to certain balances in amounts due to banks and other financial institutions disclosed above. These covenants include stipulated ratios, debt to equity ratios and various other financial performance ratios. The Group did not breach any of these covenants as at December 31, 2013 and 2012.

Nominal interest rates and maturities of these loans are as follows:

	December 31, 2013			December 31, 2012		
	Annual interest rate	Currency	Maturity	Annual interest rate	Currency	Maturity
The National Fund for Support of Entrepreneurship	1%	AZN	2014 – 2022	1%	AZN	2013 – 2022
The Azerbaijan Mortgage Fund	1% - 9%	AZN	2016 – 2043	1% - 8%	AZN	2016-2041
Commercial Banks	8% - 11.3%	AZN	2014-2015	8% - 11.3%	AZN	2013
GFM Cossack Bond Company Limited	12%	USD	2014	12%	USD	2014
German Azerbaijan Fund	4%	EUR	2015	5%	EUR	2015
Investment companies	9 - 9.6%	AZN	2014	11%	AZN	2013

## 18. AMOUNTS DUE TO CUSTOMERS

Amounts due to customers comprise:

	December 31, 2013	December 31, 2012
Time deposits	388,365	283,647
Repayable on demand	23,566	16,973
<b>Total amounts due to customers</b>	<b>411,931</b>	<b>300,620</b>

As at December 31, 2013 and 2012 amounts due to customers totaling AZN 7 thousand and AZN 3 thousand, respectively, were held as security against guarantees issued, AZN 1,031 thousand and AZN 1,460 thousand, respectively, as security against loans and AZN 26,508 thousand and AZN 1,397 thousand as security against undrawn credit facilities.

As at December 31, 2013, time deposits were due to customers with effective annual interest rates of 1% - 21 %, AZN (2012: 1% - 21%, AZN) and maturity in 2014-2024 (2012: mature in 2013-2024).

As at December 31, 2013, amounts due to customers of AZN 35,439 thousand (7%) were due to the ten (2012 - ten) largest customers of the Group (2012 – AZN 32,601 thousand (11%)).

Included in time deposits are deposits of individuals of AZN 375,437 thousand (2012 – AZN 279,620 thousand).



An analysis of customer accounts by economic sector follows:

	December 31, 2013	December 31, 2012
<b>Analysis by sector:</b>		
Individuals and employees	388,943	289,042
Trade and service	11,173	6,043
Energy	6,495	2,560
Construction	4,137	1,093
Manufacturing	806	1,145
Transport and communication	377	737
<b>Total amounts due to customers</b>	<b>411,931</b>	<b>300,620</b>

Amounts due to customers include accounts with the following types of customers:

	December 31, 2013	December 31, 2012
Individuals and employees	388,943	289,042
Private enterprises	22,736	11,494
State and budgetary organizations	252	84
<b>Total amounts due to customers</b>	<b>411,931</b>	<b>300,620</b>

## 19. DEBT SECURITIES ISSUED

Debt securities issued comprise:

	December 31, 2013	December 31, 2012
Coupon securities	16,332	10,057
<b>Total debt securities issued</b>	<b>16,332</b>	<b>10,057</b>

During the year Bank has issued additional AZN 10,000 thousand debt securities and bought back securities in the amount of AZN 4,050 thousand. As at December 31, 2013, coupon securities denominated in AZN in the amount of AZN 15,950 thousand (2012 – AZN 10,000 thousand) and bear interest rate of 12% per annum with maturity in three years. These coupon certificates state as a condition that interest is paid quarterly. There are 15,950 certificates (2012 – 10,000) with nominal value of AZN 1,000 each.

## 20. OTHER LIABILITIES

Other liabilities comprise:

	December 31, 2013	December 31, 2012
<b>Other financial liabilities:</b>		
Dividends payable to shareholders on ordinary shares	3,116	1,484
Liabilities in the course of settlement	1,118	535
Other creditors	361	6
	4,595	2,025
<b>Other non-financial liabilities:</b>		
Operational taxes	625	510
Provision for losses on guarantees and other contingent commitments	13	221
	638	731
<b>Total other liabilities</b>	<b>5,233</b>	<b>2,756</b>

## 21. SUBORDINATED DEBTS

Subordinated debts comprise:

	Issue date	Maturity date	Interest rate	December 31, 2013	December 31, 2012
Subordinated debt from foreign credit institutions - third parties (JSC Bank of Georgia, USD 2,500 thousand, semi-annual payment)	November 18, 2007	November 18, 2017	six month LIBOR plus 12.0%	1,986	1,992
Subordinated debt from related parties (NAB Dish Ticaret, USD 1,000 thousand, semi-annual payment)	March 19, 2008	March 19, 2018	19.45%	823	824
<b>Total subordinated debts</b>				<b>2,809</b>	<b>2,816</b>

In the event of bankruptcy or liquidation of the Group, repayments of these debts are subordinate to the repayments of the Group's liabilities to all other creditors.

The Group is not obligated to comply with financial covenants in relation to subordinated debt balances disclosed above.

## 22. SHARE CAPITAL

As at December 31, 2013 and 2012 the Group's shareholders' authorized, issued and fully paid capital amounted to AZN 52,870 thousand and comprised 3,400,000 ordinary shares with a par value of AZN 15.55. Each share entitles one vote to the shareholder.

During 2012 share capital of the Group was increased by AZN 26,690 thousand through capitalization of 2011 profits.

In 2013 the Group declared dividends on ordinary shares amounted to AZN 16,168 thousand from its 2012 earnings (2012: AZN 710 thousand from its 2011 earnings).

The earnings and weighted average number of shares were used in calculation of basic and diluted earnings per share (EPS). The weighted average number of ordinary shares for the purposes of basic and diluted EPS was 3,400,000 both as at December 31, 2013 and 2012. Accordingly, EPS ratio comprised AZN 13.64 and AZN 9.51 as at December 31, 2013 and 2012.

## 23. COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Group 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 consolidated statement of financial position.

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

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

	December 31, 2013	December 31, 2012
<b>Contingent liabilities and credit commitments</b>		
Commitments on loans and unused credit lines	24,693	19,141
Guarantees issued	10,454	14,674
Other transaction related contingent obligations	1,627	1,428
<b>Total contingent liabilities and credit commitments</b>	<b>36,774</b>	<b>35,243</b>



**Operating lease commitments** – Where the Group is the lessee, the future minimum lease payments under non-cancelable operating leases of buildings are as follows:

	December 31, 2013	December 31, 2012
Less than one year	126	124
<b>Total operating lease commitments</b>	<b>126</b>	<b>124</b>
<b>Commitments and contingencies (before deducting collateral)</b>	36,900	35,367
Less: Cash held as security against guarantees issued (Note 18)	(7)	(3)
Less: Cash held as security against undrawn credit facility (Note 18)	(26,508)	(1,397)
<b>Commitments and contingencies</b>	<b>10,385</b>	<b>33,967</b>

**Legal proceedings** – From time to time and in the normal course of business, claims against the Group 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 consolidated financial statements.

**Taxation** – Commercial legislation 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 Group's business activities, was to be challenged by the tax authorities, the Group 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 Group believes that it has accrued all tax amounts due and therefore no allowance has been made in the consolidated 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 may be 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.

## 24. TRANSACTIONS WITH RELATED PARTIES

Transactions between the Bank and its subsidiary, which is related party of the Bank, have been eliminated on consolidation and are not disclosed in this note. Details of transactions between the Group and other related parties are disclosed below:

	Notes	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	11		564,884		419,096
- key management personnel of the Group		524		126	
Allowance for impairment losses	11		(18,258)		(11,962)
- key management personnel of the Group		-		(1)	
Investment securities available-for-sale	12		9,071		18,578
- shareholders and entities in which a substantial interest is owned by shareholders of the Group		1,387		1,387	
Amounts due to customers	18		411,931		300,620
- shareholders and entities in which a substantial interest is owned by shareholders of the Group		10,872		4,100	
- key management personnel of the Group		1,083		4,350	
Other liabilities	20		5,233		2,756
- shareholders and entities in which a substantial interest is owned by shareholders of the Group		3,116		1,484	
Subordinated debt	21		2,809		2,816
- shareholders and entities in which a substantial interest is owned by shareholders of the Group		823		824	
Commitments on loans and unused credit lines	23		24,693		19,141
- key management personnel of the Group		1,093		79	
- shareholders and entities in which a substantial interest is owned by shareholders of the Group		49		-	
Guarantees issued	23		10,454		14,674
- shareholders and entities in which a substantial interest is owned by shareholders of the Group		9,781		12,033	



The remuneration of directors and other members of key management were 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
<b>Key management personnel compensation</b>				
- salaries and other short-term benefits	(6,344)	(23,222)	(4,476)	(16,133)
- social security costs	(370)	(3,340)	(229)	(2,612)
<b>Total key management personnel compensation (Note 7)</b>	<b>(6,714)</b>	<b>(26,562)</b>	<b>(4,705)</b>	<b>(18,745)</b>

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

		Year ended December 31, 2013		Year ended December 31, 2012	
	Notes	Related party transactions	Total category as per the financial statements caption	Related party transactions	Total category as per the financial statements caption
Interest income			137,206		94,790
- shareholders and entities in which a substantial interest is owned by shareholders of the Group		551		4	
- key management personnel of the Group		45		18	
Interest expense			(47,266)		(31,549)
- shareholders and entities in which a substantial interest is owned by shareholders of the Group		(1,333)		(356)	
- key management personnel of the Group		(196)		(484)	
Recovery of provision/(provision) for loan impairment losses	4		(8,039)		(5,143)
- key management personnel of the Group		1		-	
Fee and commission income	5		12,154		7,710
- shareholders and entities in which a substantial interest is owned by shareholders of the Group		201		21	
- key management personnel of the Group		5		2	
Other operating expenses	7		(10,127)		(6,556)
- shareholders and entities in which a substantial interest is owned by shareholders of the Group		(836)		(617)	

## 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 the Group's financial assets measured at fair value on a recurring basis.

Some of the Group's financial assets and financial liabilities are measured at fair value at the end of each reporting period.

	December 31, 2013	Valuation technique and key input	Fair value hierarchy	December 31, 2012	Valuation technique and key input	Fair value hierarchy
Investment securities available-for-sale (debt securities)	7,490	Quoted bid prices in an active market.	Level 2	16,992	Quoted bid prices in an active market.	Level 2
<b>Total investment securities available- for-sale</b>	<b>7,490</b>			<b>16,992</b>		

### Fair value of financial assets and financial liabilities that are not measured at fair value on a recurring basis (but fair value disclosures are required)

The directors consider that the carrying amounts of financial assets and financial liabilities recognised in the consolidated financial statements approximate their fair values.

	December 31, 2013			December 31, 2012		
	Level 2	Level 3	Total	Level 2	Level 3	Total
Cash and cash equivalents	40,824	-	40,824	27,160	-	27,160
Amounts due from banks and other credit institutions	15,685	-	15,685	8,900	-	8,900
Loans to customers	546,626	-	546,626	407,134	-	407,134
Investment securities available-for-sale (equity investments)	-	1,581	1,581	-	1,586	1,586
Other debt securities	5,017	-	5,017	5,015	-	5,015
Other financial assets	1,470	-	1,470	331	-	331
Amounts due to banks and other financial institutions	75,893	-	75,893	72,482	-	72,482
Amounts due to customers	411,931	-	411,931	300,620	-	300,620
Debt securities issued	16,332	-	16,332	10,057	-	10,057
Other financial liabilities	4,595	-	4,595	2,025	-	2,025
Subordinated debt	2,809	-	2,809	2,816	-	2,816

The fair values of the financial assets and financial liabilities included in the level 2 and level 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 ADEQUACY

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the ratios established by the CBAR in supervising the Bank.

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

*CBAR capital adequacy ratio*

The CBAR requires each bank or banking group to:

- a) hold the minimum level of share capital of AZN 10,000 thousand (2012: AZN 10,000 thousand);
- b) maintain a ratio of total regulatory capital to risk-weighted assets (the 'total capital ratio') at or above the prescribed minimum of 12% (2012: 12%); and
- c) maintain a ratio of Tier 1 capital to risk-weighted assets (the 'Tier 1 capital ratio') at or above the prescribed minimum of 6% (2012: 6%).

Management believes that the Bank was in compliance with the statutory capital adequacy ratio throughout 2013.

As at December 31, 2013 and 2012, the Bank's capital adequacy ratio on statutory basis was as follows:

	2013	2012
Tier 1 capital	68,989	52,438
Tier 2 capital	56,255	43,105
Investments in unconsolidated subsidiaries and other equity investments	(1,478)	(1,478)
Less: deductions from capital	<u>(1,510)</u>	<u>(1,015)</u>
<b>Total regulatory capital</b>	<b><u>122,256</u></b>	<b><u>93,050</u></b>
<b>Risk-weighted assets</b>	<b><u>598,332</u></b>	<b><u>437,040</u></b>
Tier 1 capital adequacy ratio	11.28%	11.77%
Total capital adequacy ratio	20.43%	21.29%

27. RISK MANAGEMENT POLICIES

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

- Credit exposures
- Liquidity risk
- Market risk

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

## Credit risk

The Group 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 processed are performed by the Credit Committees and the Group'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 Group 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 Group obtains collateral and corporate and personal guarantee. 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 Group 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 Group 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 grant of loans, using limits to mitigate the risk, and current monitoring. The Group 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 Group's maximum exposure to credit risk varies significantly and is dependent 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 consolidated statement of financial position, the maximum exposure is equal to the carrying amount of those assets prior to any offset or collateral. The Group'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 December 31, 2013	Maximum exposure December 31, 2012
Cash and cash equivalents (excluding cash on hand)	19,672	11,260
Amounts due from banks and other credit institutions	15,685	8,900
Loans to customers	546,626	407,134
Investment securities available-for-sale (excluding equity investments)	7,490	16,992
Other debt securities	5,017	5,015
Other financial assets	1,470	331
Commitments and contingencies	36,900	35,367



## Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

- For auto lending: cash, liens over vehicles, third party guarantees;
- For business lending: charges over real estate, inventory and trade receivables, third party guarantees;
- For consumer lending: cash, charges over credited consumer appliances, third party guarantees, mortgages over residential properties;
- For microloans: cash, inventory and trade receivables, third party guarantees, charges over real estate; and
- For card lending: cash, third party guarantees.

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

### Off – balance sheet risk

The Group 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.

### Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group's internal credit ratings. The table below shows the credit quality by class of asset for loan-related lines in the consolidated statement of financial position, based on the Group's credit rating system. In the table below loans to banks and customers of high grade are those having a minimal level of credit risk, normally with a government guarantee or very well collateralized. Other borrowers individually assessed for impairment with good financial position and good debt service and loans collectively assessed for impairment are included in the standard grade. Investment securities of high grade are those issued by government and its agencies with very low default probability and at risk free rate.

	Notes	High grade	Standard Grade	Past due but not impaired	Individually impaired	Total 2013
Amounts due from banks and other credit institutions	10	347	15,338	-	-	15,685
Loans to customers:	11					
Auto loans		32	99,572	-	-	99,604
Business loans		880	15,813	251	8,420	25,364
Consumer loans		7,077	273,231	280	-	280,588
Microloans		9,428	49,286	1	-	58,715
Cards		3,907	96,706	-	-	100,613
		<u>21,324</u>	<u>534,608</u>	<u>532</u>	<u>8,420</u>	<u>564,884</u>
Investment securities available-for-sale	12	7,490	-	-	-	7,490
Other debt securities	13	<u>5,017</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>5,017</u>
<b>Total</b>		<b><u>34,178</u></b>	<b><u>549,946</u></b>	<b><u>532</u></b>	<b><u>8,420</u></b>	<b><u>593,076</u></b>

	Notes	High grade	Standard Grade	Past due but not impaired	Individually impaired	Total 2012
Amounts due from banks and other credit institutions	10	347	8,553	-	-	8,900
Loans to customers:	11					
Auto loans		-	93,893	-	-	93,893
Business loans		19,840	17,323	-	8,192	45,355
Consumer loans		9,835	207,190	609	-	217,634
Microloans		11,371	21,571	-	-	32,942
Cards		2,148	27,124	-	-	29,272
		<u>43,194</u>	<u>367,101</u>	<u>609</u>	<u>8,192</u>	<u>419,096</u>
Investment securities available-for-sale	12	16,992	-	-	-	16,992
Other debt securities	13	<u>5,015</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>5,015</u>
<b>Total</b>		<b><u>65,548</u></b>	<b><u>375,654</u></b>	<b><u>609</u></b>	<b><u>8,192</u></b>	<b><u>450,003</u></b>

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk.

All internal risk ratings are tailored to the various categories and are derived in accordance with the Group's rating policy. The attributable risk ratings are assessed and updated regularly.

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

	Less than 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total 2013
Loans to customers:					
Business loans	251	-	-	-	251
Consumer loans	20	11	21	228	280
Microloans	<u>1</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1</u>
<b>Total</b>	<b><u>272</u></b>	<b><u>11</u></b>	<b><u>21</u></b>	<b><u>228</u></b>	<b><u>532</u></b>

	Less than 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total 2012
Loans to customers:					
Consumer loans	<u>20</u>	<u>16</u>	<u>22</u>	<u>551</u>	<u>609</u>
<b>Total</b>	<b><u>20</u></b>	<b><u>16</u></b>	<b><u>22</u></b>	<b><u>551</u></b>	<b><u>609</u></b>

#### *Impairment assessment*

The main considerations for the loan impairment assessment are based on the information provided by the roll-rate model, which measures the movement of the past due amounts balances in various time brackets. The Group addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.



### *Individually assessed allowances*

The Group determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realizable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

### *Collectively assessed allowances*

Allowances are assessed collectively for losses on loans to customers that are not individually significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration the roll-rate model assessment. The impairment allowance is then reviewed by credit management to ensure alignment with the Group's overall policy.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for loans.

### **Geographical concentration**

The Risk Management Committee exercises control over the risk in the legislation and regulatory arena and assesses its influence on the Group's activity. This approach allows the Group 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	Other non- OECD countries	OECD countries	December 31, 2013 Total
<b>NON-DERIVATIVE FINANCIAL ASSETS</b>				
Cash and cash equivalents	23,947	165	16,712	40,824
Amounts due from banks and other credit institutions	15,338	-	347	15,685
Loans to customers	546,626	-	-	546,626
Investment securities available-for-sale	9,071	-	-	9,071
Other debt securities	5,017	-	-	5,017
Other financial assets	1,470	-	-	1,470
<b>Total non-derivative financial assets</b>	<b>601,469</b>	<b>165</b>	<b>17,059</b>	<b>618,693</b>
<b>NON-DERIVATIVE FINANCIAL LIABILITIES</b>				
Amounts due to banks and other financial institutions	61,332	1,987	12,574	75,893
Amounts due to customers	411,931	-	-	411,931
Debt securities issued	16,332	-	-	16,332
Other financial liabilities	4,440	-	155	4,595
Subordinated debt	-	1,986	823	2,809
<b>Total non-derivative financial liabilities</b>	<b>494,035</b>	<b>3,973</b>	<b>13,552</b>	<b>511,560</b>
<b>NET POSITION</b>	<b>107,434</b>	<b>(3,808)</b>	<b>3,507</b>	<b>107,133</b>

	The Republic of Azerbaijan	Other non-OECD countries	OECD countries	December 31, 2012 Total
<b>NON-DERIVATIVE FINANCIAL ASSETS</b>				
Cash and cash equivalents	22,377	254	4,529	27,160
Amounts due from banks and other credit institutions	8,553	-	347	8,900
Loans to customers	407,134	-	-	407,134
Investment securities available-for-sale	18,578	-	-	18,578
Other debt securities	5,015	-	-	5,015
Other financial assets	331	-	-	331
<b>Total non-derivative financial assets</b>	<b>461,988</b>	<b>254</b>	<b>4,876</b>	<b>467,118</b>
<b>NON-DERIVATIVE FINANCIAL LIABILITIES</b>				
Amounts due to banks and other financial institutions	63,081	2,255	7,146	72,482
Amounts due to customers	300,620	-	-	300,620
Debt securities issued	10,057	-	-	10,057
Other financial liabilities	1,954	-	71	2,025
Subordinated debt	-	1,992	824	2,816
<b>Total non-derivative financial liabilities</b>	<b>375,712</b>	<b>4,247</b>	<b>8,041</b>	<b>388,000</b>
<b>NET POSITION</b>	<b>86,276</b>	<b>(3,993)</b>	<b>(3,165)</b>	<b>79,118</b>

### *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 Group'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 Group performs daily monitoring of future expected cash flows on clients' and banking operations, which is a part of 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 based on contractual undiscounted cash outflows is presented in the following table. The presentation below is based upon the information provided internally to key management personnel of the Group.

Financial liabilities As at December 31, 2013	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Amounts due to banks and other financial institutions	7,741	34,243	27,304	16,928	86,216
Amounts due to customers	85,063	218,681	161,632	5	465,381
Debt securities issued	186	1,755	18,666	-	20,607
Other financial liabilities	-	4,595	-	-	4,595
Subordinated debt	77	331	4,047	-	4,455
Commitments on loans and unused credit lines	1,608	4,609	18,476	-	24,693
<b>Total undiscounted financial liabilities</b>	<b>94,675</b>	<b>264,214</b>	<b>230,125</b>	<b>16,933</b>	<b>605,947</b>



<b>Financial liabilities As at December 31, 2012</b>	<b>Less than 3 months</b>	<b>3 to 12 months</b>	<b>1 to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>
Amounts due to banks and other financial institutions	9,081	38,244	23,519	6,893	77,737
Amounts due to customers	57,280	165,945	119,613	5	342,843
Debt securities issued	303	900	12,400	-	13,603
Other financial liabilities	-	2,025	-	-	2,025
Subordinated debts	77	328	3,579	861	4,845
Commitments on loans and unused credit lines	4,538	4,500	3,561	6,542	19,141
<b>Total undiscounted financial liabilities</b>	<b>71,279</b>	<b>211,942</b>	<b>162,672</b>	<b>14,301</b>	<b>460,194</b>

The table below shows an analysis of financial assets and financial liabilities according to maturity.

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	December 31, 2013 Total
<b>NON-DERIVATIVE FINANCIAL ASSETS</b>								
Fixed interest rate instruments								
Cash and cash equivalents	0.50%	-	46	-	-	-	-	46
Amounts due from banks and other credit institutions	6.27%	-	3,000	-	-	-	-	3,000
Loans to customers	23.59%	40,466	56,513	237,556	205,071	7,020	-	546,626
Other debt securities	3.05%	-	-	-	3,181	1,836	-	5,017
Total fixed interest bearing financial assets		40,466	59,559	237,556	208,252	8,856	-	554,689
Non-interest bearing financial assets								
Cash and cash equivalents		40,778	-	-	-	-	-	40,778
Amounts due from banks and other credit institutions		-	-	-	-	-	12,685	12,685
Investment securities available for sale		7,493	-	-	-	1,578	-	9,071
Other financial assets		1,470	-	-	-	-	-	1,470
Total non-interest bearing financial assets		49,741	-	-	-	1,578	12,685	64,004
<b>Total non-derivative financial assets and precious metals</b>		<b>90,207</b>	<b>59,559</b>	<b>237,556</b>	<b>208,252</b>	<b>10,434</b>	<b>12,685</b>	<b>618,693</b>
<b>NON-DERIVATIVE FINANCIAL LIABILITIES</b>								
Fixed interest rate instruments								
Amounts due to banks and other financial institutions	7.90%	3,875	1,818	31,199	21,591	13,891	-	72,374
Amounts due to customers	12.01%	23,174	33,826	199,379	131,982	4	-	388,365
Debt securities issued	12.00%	-	87	295	15,950	-	-	16,332
Subordinated debts	19.45%	-	-	39	784	-	-	823
Total fixed interest bearing financial liabilities		27,049	35,731	230,912	170,307	13,895	-	477,894
Variable interest rate instruments								
Subordinated debts	12.84%	-	-	25	1,961	-	-	1,986
Amounts due to banks and other financial institutions	3.84%	-	-	908	1,333	-	-	2,241
Total variable interest bearing financial liabilities		-	-	933	3,294	-	-	4,227
Non-interest bearing financial liabilities and commitments								
Amounts due to banks and other financial institutions		1,278	-	-	-	-	-	1,278
Amounts due to customers		23,566	-	-	-	-	-	23,566
Other financial liabilities		4,595	-	-	-	-	-	4,595
Commitments on loans and unused credit lines		668	940	4,609	18,476	-	-	24,693
Total non-interest bearing financial liabilities and commitments		30,107	940	4,609	18,476	-	-	54,132
<b>Total non-derivative financial liabilities and commitments</b>		<b>57,156</b>	<b>36,671</b>	<b>236,454</b>	<b>192,077</b>	<b>13,895</b>		
Interest sensitivity gap		13,417	23,828	5,711	34,651	(5,039)		
<b>Cumulative interest sensitivity gap</b>		<b>13,417</b>	<b>37,245</b>	<b>42,956</b>	<b>77,607</b>	<b>72,568</b>		
Liquidity gap		33,051	22,888	1,102	16,175	(3,461)		
<b>Cumulative liquidity gap</b>		<b>33,051</b>	<b>55,939</b>	<b>57,041</b>	<b>73,216</b>	<b>69,755</b>		



	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	December 31, 2012 Total
<b>NON-DERIVATIVE FINANCIAL ASSETS</b>								
Fixed interest rate instruments								
Cash and cash equivalents	1.91%	-	2,543	-	-	-	-	2,543
Amounts due from banks and other credit institutions	12.50%	3	-	256	-	-	-	259
Loans to customers	28.88%	33,697	52,445	184,339	131,534	5,119	-	407,134
Investment securities available-for-sale	1.70%	16,992	-	-	-	-	-	16,992
Other debt securities	3.05%	5,015	-	-	-	-	-	5,015
Total fixed interest bearing financial assets		55,707	54,988	184,595	131,534	5,119	-	431,943
Non-interest bearing financial assets								
Cash and cash equivalents		24,617	-	-	-	-	-	24,617
Amounts due from banks and other credit institutions		-	-	-	-	-	8,641	8,641
Investment securities available-for-sale		-	-	-	-	-	1,586	1,586
Other financial assets		331	-	-	-	-	-	331
Total non-interest bearing financial assets		24,948	-	-	-	-	10,227	35,175
<b>Total non-derivative financial assets</b>		<b>80,655</b>	<b>54,988</b>	<b>184,595</b>	<b>131,534</b>	<b>5,119</b>	<b>10,227</b>	<b>467,118</b>
<b>NON-DERIVATIVE FINANCIAL LIABILITIES</b>								
Fixed interest rate instruments								
Amounts due to banks and other financial institutions	7.37%	1,201	5,698	35,135	21,733	5,259	-	69,026
Amounts due to customers	12.60%	13,222	22,086	150,744	97,590	5	-	283,647
Debt securities issued	12.00%	-	57	-	10,000	-	-	10,057
Subordinated debts	19.45%	-	-	39	-	785	-	824
Total fixed interest bearing financial liabilities		14,423	27,841	185,918	129,323	6,049	-	363,554
Variable interest rate instruments								
Subordinated debts	12.81%	-	-	29	1,963	-	-	1,992
Amounts due to banks and other financial institutions	4.43%	-	-	744	1,443	-	-	2,187
Total variable interest bearing financial liabilities		-	-	773	3,406	-	-	4,179
Non-interest bearing financial liabilities								
Amounts due to banks and other financial institutions		1,269	-	-	-	-	-	1,269
Amounts due to customers		16,973	-	-	-	-	-	16,973
Other financial liabilities		541	-	-	-	1,484	-	2,025
Commitments on loans and unused credit lines		4,538	4,500	3,561	6,542	-	-	19,141
Total non-interest bearing financial liabilities		23,321	4,500	3,561	6,542	1,484	-	39,408
<b>Total non-derivative financial liabilities</b>		<b>37,744</b>	<b>32,341</b>	<b>190,252</b>	<b>139,271</b>	<b>7,533</b>		
Interest sensitivity gap		41,284	27,147	(2,096)	(1,195)	(930)		
<b>Cumulative interest sensitivity gap</b>		<b>41,284</b>	<b>68,431</b>	<b>66,335</b>	<b>65,140</b>	<b>64,210</b>		
Liquidity gap		42,911	22,647	(5,657)	(7,737)	(2,414)		
<b>Cumulative liquidity gap</b>		<b>42,911</b>	<b>65,558</b>	<b>59,901</b>	<b>52,164</b>	<b>49,750</b>		

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 amounts included above for variable interest rate instruments for both non-derivative financial assets and liabilities is subject to change if changes in variable interest rates differ to those estimates of interest rates determined at the end of the reporting period.

**Market risk**

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates and foreign exchanges. The Group does not have any significant equity, corporate fixed income or derivatives holdings.

**Interest rate risk**

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The risk is managed by the Group by matching floating rate borrowings and assets. Additionally the ALMC on quarterly basis reviews the overall interest rate spreads by detailed analysis of the assets and liabilities interest rate structure. The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Group’s income statement.

The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at December 31, 2013 and 2012, respectively.

		Increase in % rate 2013	Sensitivity of net interest income 2013	Increase in % rate 2012	Sensitivity of net interest income 2012
Currency					
USD		1%	(20)	1%	(20)
EUR		1%	(22)	1%	(22)

		Decrease in % rate 2013	Sensitivity of net interest income 2013	Decrease in % rate 2012	Sensitivity of net interest income 2012
Currency					
USD		(1%)	20	(1%)	20
EUR		(1%)	22	(1%)	22

**Currency risk**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Supervisory Board of the Group has set limits on positions by currency based on the CBAR regulations. The Treasury Department monitors the currency position of the Group on a daily basis.

The tables below indicate the currencies to which the Group had significant exposure at December 31, 2013 and 2012, respectively, on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the AZN, with all other variables held constant on the income statement. The effect on equity does not differ from the effect on the income statement. A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase.

Currency	Increase in currency rate in % 2013	Effect on profit before tax 2013	Increase in currency rate in % 2012	Effect on profit before tax 2012
USD	10.00%	(993)	10%	(790)
EUR	10.00%	70	10%	70



Currency	Decrease in currency rate in % 2013	Effect on profit before tax 2013	Decrease in currency rate in % 2012	Effect on profit before tax 2012
USD	(10.00%)	993	(10%)	790
EUR	(10.00%)	(70)	(10%)	(70)

#### 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 Group's assets and liabilities are actively managed. Additionally, the financial position of the Group may vary at the time that any actual market movement occurs. For example, the Group'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 Group'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.

#### **Price risk-own products**

The Group is exposed to price risks of its products which are subject to general and specific market fluctuations.

The Group manages price risk through periodic estimation of potential losses that could arise from adverse changes in market conditions and establishing and maintaining appropriate stop-loss limits and margin and collateral requirements. With respect to undrawn loan commitments the Group is potentially exposed to a loss of an amount equal to the total amount of such commitments. However, the likely amount of a loss is less than that, since most commitments are contingent upon certain conditions set out in the loan agreements.

#### **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 Group cannot expect to eliminate all operational risks, but it endeavors 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.