“PARABANK” OPEN JOINT STOCK COMPANY

The International Financial Reporting Standards Financial Statements and Independent Auditors’ Report
For the Year Ended December 31, 2011

“PARABANK” OPEN JOINT STOCK COMPANY

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STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011

The following statement is made with a view to distinguishing respective responsibilities of the management and those of the independent auditors in relation to the financial statements of "Parabank" Open Joint Stock Company (the "Bank").

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Bank as at December 31, 2011, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgements and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Preparing the financial statements on a going concern basis, unless it is inappropriate to presume that the Bank will continue in business for the foreseeable future.

Management is also responsible for:

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

The financial statements for the year ended December 31, 2011 were authorized for issue on April 17, 2012 by the Management Board of the Bank.

On behalf of the Management Board:

Vali Guliyev
Chairman of the Management Board

April 17, 2012
Baku, the Republic of Azerbaijan

Nigar Mehdiyeva
Financial Director

April 17, 2012
Baku, the Republic of Azerbaijan

INDEPENDENT AUDITORS' REPORT

To the Shareholders and the Board of Directors of "Parabank" Open Joint Stock Company:

We have audited the accompanying financial statements of "Parabank" Open Joint Stock Company (the "Bank"), which comprise the statement of financial position as at December 31, 2011, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2011, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

April 17, 2012
Baku, the Republic of Azerbaijan

"PARABANK" OPEN JOINT STOCK COMPANY

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 2011
(In thousands of Azerbaijani Manats)

	Notes	Year ended December 31, 2011	Year ended December 31, 2010
Interest income	5,24	16,389	17,362
Interest expense	5,24	(10,124)	(11,030)
Net interest income before provision for impairment losses on interest bearing assets		**6,265**	**6,332**
Provision for impairment losses on interest bearing assets	6,24	(1,040)	(921)
Net interest income		**5,225**	**5,411**
Net gain on foreign exchange operations	7	253	237
Fee and commission income	8	2,036	1,895
Fee and commission expense	8	(409)	(277)
Other income		46	20
Net non-interest income		**1,926**	**1,875**
Operating income		**7,151**	**7,286**
Operating expenses	9,24	(7,812)	(7,086)
(Loss)/profit before income tax		**(661)**	**200**
Income tax benefit	10	82	7
(Loss)/profit for the year		**(579)**	**207**
TOTAL COMPREHENSIVE (LOSS)/INCOME FOR THE YEAR		**(579)**	**207**
Loss per share			
Basic and diluted (*AZN*)	11	(14.81)	(1.99)

On behalf of the Management Board:

Vali Quliyev
Chairman of the Management Board

April 17, 2012
Baku, the Republic of Azerbaijan

Nigar Mehdiyeva
Financial Director

April 17, 2012
Baku, the Republic of Azerbaijan

The notes on pages 9-62 form an integral part of these financial statements.

STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2011
(In thousands of Azerbaijani Manats)

	Notes	December 31, 2011	December 31, 2010
ASSETS			
Cash and balances with the Central Bank of the Republic of Azerbaijan	12	4,182	3,993
Due from banks	13	4,236	7,489
Loans to customers	14,24	77,203	74,372
Available-for-sale investments	15	500	2,971
Property and equipment	16	11,884	12,234
Deferred tax asset	10	237	155
Other assets	17	1,674	1,353
TOTAL ASSETS		**99,916**	**102,567**
LIABILITIES AND EQUITY			
LIABILITIES:			
Due to banks and other financial institutions	18	18,430	19,189
Customer accounts	19	70,663	70,211
Debt securities issued	20	634	1,756
Other liabilities	21	402	767
Total liabilities		**90,129**	**91,923**
EQUITY:			
Share capital	22	11,570	11,570
Accumulated deficit		(1,783)	(926)
Total equity		**9,787**	**10,644**
TOTAL LIABILITIES AND EQUITY		**99,916**	**102,567**

On behalf of the Management Board:

Vali Quliyev
Chairman of the Management Board

April 17, 2012
Baku, the Republic of Azerbaijan

Nigar Mehdiyeva
Financial Director

April 17, 2012
Baku, the Republic of Azerbaijan

The notes on pages 9-62 form an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2011
(In thousands of Azerbaijani Manats)

	Share capital	Accumulated deficit	Total equity
December 31, 2009	**10,070**	**(834)**	**9,236**
Issue of preference shares	1,500	-	1,500
Dividends declared on preference shares	-	(299)	(299)
Total comprehensive income for the year	-	207	207
December 31, 2010	**11,570**	**(926)**	**10,644**
Dividends declared on preference shares	-	(278)	(278)
Total comprehensive loss for the year	-	(579)	(579)
December 31, 2011	**11,570**	**(1,783)**	**9,787**

On behalf of the Management Board:

Vali Quliyev
Chairman of the Management Board

April 17, 2012
Baku, the Republic of Azerbaijan

Nigar Mehdiyeva
Financial Director

April 17, 2012
Baku, the Republic of Azerbaijan

The notes on pages 9-62 form an integral part of these financial statements.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2011
(In thousands of Azerbaijani Manats)

	Notes	Year ended December 31, 2011	Year ended December 31, 2010
CASH FLOWS FROM OPERATING ACTIVITIES:			
Interest received		15,398	15,515
Interest paid		(10,417)	(11,673)
Income from dealing operations		302	199
Fees and commissions received		2,036	1,895
Fees and commissions paid		(409)	(277)
Other operating income received		46	20
Other operating expenses paid		(6,763)	(6,910)
Cash inflow/(outflow) from operating activities before changes in operating assets and liabilities		193	(1,231)
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposits with the Central Bank of the Republic of Azerbaijan		(848)	(71)
Due from banks		1,707	1,585
Loans to customers		(3,834)	(12,716)
Other assets		203	1,632
Increase/(decrease) in operating liabilities:			
Due to banks and other financial institutions		(681)	4,000
Customer accounts		1,130	10,695
Other liabilities		(400)	399
Cash (outflow)/inflow from operating activities before taxation		(2,530)	4,293
Income tax paid		(79)	(300)
Net cash (outflow)/inflow from operating activities		**(2,609)**	**3,993**
CASH FLOWS FROM INVESTING ACTIVITIES:			
Payments for property and equipments	16	(489)	(2,355)
Payments for intangible assets	17	(10)	(8)
Proceeds on sale/(payments) for available-for-sale investments		2,471	(2,471)
Net cash inflow/(outflow) from investing activities		**1,972**	**(4,834)**
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issue of preference shares		-	1,500
Repayment of debt securities issued (including interest paid)		(1,101)	(1,289)
Dividends paid on preference shares		(278)	(299)
Net cash outflow from financing activities		**(1,379)**	**(88)**

(In thousands of Azerbaijani Manats)

Effect of foreign exchange rate changes on cash and cash equivalents		(32)	(61)
NET DECREASE IN CASH AND CASH EQUIVALENTS		(2,048)	(990)
CASH AND CASH EQUIVALENTS, *beginning of the year*	12	7,331	8,321
CASH AND CASH EQUIVALENTS, *end of the year*	12	5,283	7,331

On behalf of the Management Board:

Vali Guliyev
Chairman of the Management Board

April 17, 2012
Baku, the Republic of Azerbaijan

Nigar Mehdiyeva
Financial Director

April 17, 2012
Baku, the Republic of Azerbaijan

The notes on pages 9-62 form an integral part of these financial statements.

(In thousands of Azerbaijani Manats)

1. INTRODUCTION

Organization and its principal activity

“Parabank” Open Joint Stock Company (the “Bank”) was established on December 3, 1991 as a limited liability company under the laws of the Republic of Azerbaijan. On January 19, 1993, the Bank was re-registered as a joint stock commercial bank. On March 14, 2008, the Bank was re-registered by the Ministry of Justice of the Republic of Azerbaijan as a “Parabank” Open Joint Stock Company. The Bank is registered in the Republic of Azerbaijan to provide commercial banking services and has been operating under a full banking licence # 02-10/41 dated January 23, 2001 granted by the Central Bank of the Republic of Azerbaijan (“CBRA”). The Bank has a licence of the CBRA # 19 dated August 6, 2002, which allows issuing local plastic cards and processing transactions with them. On May 10, 2008, the CBRA granted the Bank licence # 30 for export and import operations with foreign currency notes. The Bank’s primary business consists of commercial activities, trading with securities, foreign currencies, originating loans and guarantees.

The Bank participates in the state deposit insurance program, which was introduced by the law of the Republic of Azerbaijan, “Insurance of the Deposits of Individuals in the Republic of Azerbaijan” dated December 29, 2006. The State Deposit Insurance Fund guarantees full repayment of deposits of individuals up to AZN 30,000 equivalent, which bears lower or equal to 12 percent interest rate per annum (Limits of interest rate changes in accordance with change in CBRA refinancing rate. The indicated limit is applicable to reporting date).

Registered address and place of business

The registered office of the Bank is 60, S.Vurgun Street, Baku AZ1022, the Republic of Azerbaijan. As at December 31, 2011, the Bank had 16 branches of which 8 are located in regions operating in the Republic of Azerbaijan (2010: 16 branches of which 8 are located in regions).

Shareholders of the Bank

As at December 31, 2011 and 2010, the following individuals owned issued shares of the Bank:

	December 31, 2011, %	December 31, 2010, %
Ordinary shareholders		
Guliyeva Alevtina	21.5	21.5
Hajiyeva Tamilla	21.2	21.2
Guliyev Eldar	21.1	21.1
Guliyev Vali	19.2	19.2
Guliyev Elnur	10.9	10.9
Poladov Rasim	5.4	5.4
Others	0.7	0.7
Total ordinary shareholders	**100.0**	**100.0**
Preference shareholders		
Safarli Ayaz	32.6	32.6
Safarov Ibrahim	32.6	32.6
Guliyev Elnur	21.6	21.6
Sadigova Yazagul	4.2	4.2
Bagirova Vusala	4.2	4.2
Guliyev Eldar	2.3	2.3
Hajiyeva Tamilla	1.5	1.5
Guliyeva Aliftina	1.0	1.0
Total preference shareholders	**100.0**	**100.0**

Operating Environment of the Bank

The Republic of Azerbaijan displays certain characteristics of an emerging market, including the existence of a currency that is not freely convertible in most countries outside of the Republic of Azerbaijan, restrictive currency controls, relatively high inflation and economic growth. The banking sector in the Republic of Azerbaijan is sensitive to adverse fluctuations in confidence and economic conditions. The Azerbaijani economy occasionally experiences falls in confidence in the banking sector accompanied by reductions in liquidity. Management is unable to predict economic trends and developments in the banking sector and what effect, if any, a deterioration in the liquidity of or confidence in the Republic of Azerbaijan banking system could have on the financial position of the Bank.

The tax, currency and customs legislation within the Republic of Azerbaijan is subject to varying interpretations, and changes, which can occur frequently. Furthermore, the need for further developments in the bankruptcy laws, the absence of formalized procedures for the registration and enforcement of collateral, and other legal and fiscal impediments contribute to the difficulties experienced by banks currently operating in the Republic of Azerbaijan. The future economic direction of the Republic of Azerbaijan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments

2. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

These financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board (“IASB”) and Interpretations issued by the International Financial Reporting Interpretations Committee (“IFRIC”).

Going concern

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

Other basis of presentation criteria

These financial statements are presented in thousands of Azerbaijani Manats (“AZN”), unless otherwise indicated. These financial statements have been prepared under the historical cost convention.

The Bank maintains its accounting records in accordance with the laws of the Republic of Azerbaijan. These financial statements have been prepared from the statutory accounting records and have been adjusted to conform to IFRS. These adjustments include certain reclassifications to reflect the economic substance of underlying transactions including reclassifications of certain assets and liabilities, income and expenses to appropriate financial statement captions.

The principal accounting policies are set out below:

Recognition of interest income and expense

Interest income and expense are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash payments or 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 financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

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 and expense

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 and loss accounts 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 the profit and loss accounts on expiry. Loan servicing fees are recognized as revenue as the services are provided. All other commissions are recognized when services are provided.

Financial instruments

The Bank recognizes financial assets and liabilities in its statement of financial position when it becomes a party to the contractual obligations of the instrument. Regular way purchases and sales of financial assets and liabilities are recognized using settlement date accounting.

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

Financial assets

Financial assets are classified into the following specified categories: financial assets “at fair value through profit or loss” (FVTPL), “held-to-maturity” investments, “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.

Financial assets at FVTPL

Financial assets classified as held for trading are included in the category "financial assets at fair value through profit or loss". Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognized in the profit and loss accounts.

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Bank has the positive intent and ability to hold to maturity.

Held-to-maturity investments are measured at amortized cost using the effective interest method less any impairment.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortized cost using the effective interest method.

Gains and losses are recognized in profit and loss accounts when the loans and receivables are derecognized or impaired, as well as through the amortisation process.

Available-for-sale investments

Available-for-sale investments financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition available-for-sale investments financial assets are measured at fair value with gains or losses being recognized in other comprehensive income until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to profit and loss accounts. However, interest calculated using the effective interest method is recognized in profit and loss accounts.

Determination of fair value

The fair value for financial instruments traded in active market at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, unrestricted balances on correspondent and time deposit accounts with the CBRA and advances to banks in countries included in the Organization for Economic Co-operation and Development ("OECD") with original maturities up to 90 days. For purposes of determining cash flows, the minimum reserve deposits required by the CBRA are not included as a cash equivalent due to restrictions on its availability.

Due from banks

In the normal course of business, the Bank maintains advances or deposits for various periods of time with other banks. Due from banks are initially recognized at a fair value. Due from banks with a fixed maturity term are subsequently measured at amortized cost using the effective interest method and are carried net of any allowance for impairment losses. Those that do not have fixed maturities are carried at amortized cost based on expected maturities. Amounts due from financial institutions are carried net of any allowance for impairment losses.

Loans to customers

Loans to customers are non-derivative assets with fixed or determinable payments that are not quoted in an active market, other than those classified in other categories of financial assets.

Loans granted by the Bank are initially recognized at a fair value plus related transaction costs. Where the fair value of consideration given does not equal the fair value of the loan, for example where the loan is issued at lower than market rates, the difference between the fair value of consideration given and the fair value of the loan is recognized as a loss on initial recognition of the loan and included in the statement of comprehensive income according to nature of these losses. Subsequently, loans are carried at amortized cost using the effective interest method. Loans to customers are carried net of any allowance for impairment losses.

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- A financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity;
- Other financial assets may be reclassified to available-for-sale or held-to-maturity categories only in rare circumstances.

A financial asset classified as available-for-sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category of the Bank has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit and loss accounts is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable.

Impairment of financial assets

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Assets carried at amortized cost

The Bank accounts for impairment losses of financial assets when there is objective evidence that a financial asset or a group of financial assets is impaired. Impairment losses are measured as the difference between carrying amounts and the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted at the financial asset’s original effective interest rate.

Such impairment losses are not reversed, unless 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, such as recoveries, in which case the previously recognized impairment loss is reversed by adjustment of an allowance account.

For financial assets carried at cost, impairment losses are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows, discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

Available-for-sale investments

For available-for-sale investments financial investments, the Bank assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as investments available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognized in profit and loss accounts – is reclassified from other comprehensive income to profit and loss accounts. Impairment losses on equity investments are not reversed through profit or loss; increases in their fair value after impairment are recognized in other comprehensive income.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in profit and loss accounts. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit and loss accounts, the impairment loss is reversed through profit and loss accounts.

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.

Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously 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 or current effective interest rate.

Write off 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 exercized all possibilities available to collect amounts due to the Bank and after the Bank has sold all available collateral. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in profit and loss accounts in the period of recovery.

Derecognition of financial assets

The Bank derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognize the financial asset and also recognizes a collateralized 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 and loss accounts.

On derecogntion of a financial asset other than in its entirety (for example, when the Bank retains an option to repurchase part of the transferred asset or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the Bank retains control), the Bank allocates the previous carrying amount of the financial asset between the part it continues to recognize under continuing involvement, and the part it no longer recognizes 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 recognized and the sum of the consideration received for the part no longer recognized and any cumulative gain or loss allocated to it that had been recognized in other comprehensive income is recognized in profit and loss accounts. A cumulative gain or loss that had been recognized in other comprehensive income is allocated between the part that continues to be recognized and the part that is no longer recognized on the basis of the relative fair values of those parts.

Financial liabilities and equity instruments

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 instruments

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

Financial liabilities

Financial liabilities are classified as either financial liabilities “at FVTPL” or “other financial liabilities”.

FVTPL

Financial liabilities are classified as FVTPL when either the financial liability is held for trading or it is designated as at FVTPL.

Financial liabilities at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognized in profit and loss accounts. The net gain or loss recognized in profit and loss accounts incorporates any interest paid on the financial liability and is included in the “other income/(loss)” line item in the statement of comprehensive income.

Other financial liabilities

Other financial liabilities are initially measured at fair value, net of transaction costs.

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

The effective interest method is a method of calculating the amortized 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 through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Due to banks and other financial institutions

Amounts due to banks and other financial institutions are recorded when money or other assets are advanced to the Bank by counterparty banks. The non-derivative liability is carried at amortized cost. If the Bank purchases its own debt, it is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from early retirement of debt.

Customer accounts

Customer accounts are non-derivative liabilities to individuals, state or corporate customers and are carried at amortized cost.

Debt securities issued

Debt securities issued include promissory notes, bonds, certificates of deposit and debentures issued by the Bank. Debt securities are stated at amortized cost. If the Bank purchases its own debt securities in issue, they are removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains arising from retirement of debt.

Financial guarantee contracts

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

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

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

Derecognition of financial liabilities

The Bank derecognizes financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit and loss accounts.

Offset of financial assets and liabilities

Financial assets and liabilities are offset and reported net on the statement of financial position when the Bank has a legally enforceable right to set off the recognized amounts and the Bank intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. In accounting for a transfer of a financial asset that does not qualify for derecognition, the Bank does not offset the transferred asset and the associated liability.

Operating leases

Operating lease payments are recognized 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 recognized 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 recognized as a liability. The aggregate benefit of incentives is recognized 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.

Property, equipment and intangible assets

Property, equipment and intangible assets are carried at historical cost less accumulated depreciation and amortization and any recognized impairment loss.

Depreciation on assets under construction and those not placed in service commences from the date the assets are ready for their intended use.

Depreciation and amortization are charged on the carrying value of property, equipment and intangible assets and is designed to write off assets over their useful economic lives. The estimated useful lives, residual values and depreciation/amortization 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 fixtures	15%
Computers	20%
Vehicles	10%
Leasehold Improvements	20-33%
Intangible assets	10%

Freehold land is not depreciated.

Expenses related to repairs and renewals are charged when incurred and included in operating expenses unless they qualify for capitalization.

Leasehold improvements are amortized over the life of the related leased asset. Expenses related to repairs and renewals are charged when incurred and included in operating expenses unless they qualify for capitalization.

Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognized 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 with indefinite useful lives that are acquired separately are carried at cost less accumulated impairment losses.

At the end of each reporting period, the Bank reviews the carrying amounts of its property, equipment 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 Bank estimates the recoverable amount of the cash-generating unit to which the asset belongs.

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 recognized immediately in profit and loss accounts, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where 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 recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit and loss accounts, 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.

An item of property, equipment and intangible assets is derecognized 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 recognized in profit and loss accounts.

Taxation

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

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

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each reporting date 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 is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the statement of compehensive income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the statement of financial position if:

- The Bank has a legally enforceable right to set off current income tax assets against current income tax liabilities; and
- Deferred income tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

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

Provisions

Provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the obligation can be made.

The amount recognized 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 recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Retirement and other benefit obligations

In accordance with the requirements of the legislation of the Republic of Azerbaijan state pension system provides for the calculation of current payments by the employer as a percentage of current total payments to staff. This expense is charged in the period the related salaries are earned. Upon retirement all retirement benefit payments are made by pension funds selected by employees. The Bank does not have any pension arrangements separate from the state pension system of the Republic of Azerbaijan. In addition, the Bank has no post-retirement state benefits or other significant compensated benefits requiring accrual.

Contingencies

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

(In thousands of Azerbaijani Manats)

Share capital

- ***Ordinary shares*** - Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognized as a deduction from equity, net of any tax effects. Dividends on ordinary shares are recognized in equity as a reduction in the period in which they are declared;
- ***Preference shares*** - Preference shares are classified as equity if they are non-redeemable, or redeemable only at the Bank’s option, and any dividends are discretionary. Dividends thereon are recognized as distributions within equity upon approval by the Bank’s shareholders.

Preference shares are classified as a financial liability if it is redeemable on a specific date or at the option of the shareholders, or if dividend payments are not discretionary. Dividends thereon are recognized as finance cost in profit and loss accounts as accrued.

Dividends that are declared after the reporting date are treated as a subsequent event under International Accounting Standard 10 “Events after the Reporting Date” (“IAS 10”) and disclosed accordingly.

Foreign currency translation

The functional currency of the Bank is the currency of the primary economic environment, in which it operates. The Bank’s functional currency is AZN.

Monetary assets and liabilities denominated in foreign currencies are translated into AZN at the appropriate spot rates of exchange of the CBRA ruling at the end of reporting date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction. Profits and losses arising from these translations are included in net gain/(loss) on foreign exchange operations.

Rates of exchange

The exchange rates at reporting date used by the Bank in the preparation of the financial statements are as follows:

	December 31, 2011	**December 31, 2010**
USD/AZN	0.7865	0.7979
EUR/AZN	1.0178	1.0560
RUR/AZN	0.0245	0.0263

Segment reporting

Operating segments are identified on the basis of internal reports about components of the Bank that are regularly reviewed by the chief operating decision maker in order to allocate resources to the segment and to assess its performance. The Bank’s segmental reporting is based on the following operating segments: Retail banking (Principally handling individual customers’ deposits, and providing consumer loans, overdrafts, credit cards facilities and funds transfer facilities) and Corporate banking (Principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers).

The Bank measures information about reportable segments in accordance with IFRS. Information about reportable operating segment meets any one of the following quantitative thresholds:

- Its reported revenue, from both external customers and inter-segment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments; or
- The absolute measure of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss; or
- Its assets are 10 per cent or more of the combined assets of all operating segments.

If the total external revenue reported by operating segments constitutes less than 75 per cent of the entity's revenue, additional operating segments are identified as reportable segments (even if they do not meet the quantitative thresholds set out above) until at least 75 per cent of the Bank's revenue is included in reportable segments.

Critical accounting judgements and key sources of estimation uncertainty

The preparation of the Bank's financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the reporting date and the reported amount of income and expenses during the period ended. Management evaluates its estimates and judgments on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The following estimates and judgments are considered important to the portrayal of the Bank's financial condition.

Allowance for impairment of loans

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

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

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

The carrying amount of the allowance for impairment of loans to customers is AZN 4,329 thousand and AZN 3,289 as at December 31, 2011 and 2010, respectively.

Valuation of financial Instruments

Financial instruments that are classified at a fair value through profit or loss or available-for-sale, and all derivatives, are stated at a fair value. The fair value of such financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. If a quoted market price is available for an instrument, the fair value is calculated based on the market price. When valuation parameters are not observable in the market or cannot be derived from observable market prices, the fair value is derived through analysis of other observable market data appropriate for each product and pricing models which use a mathematical methodology based on accepted financial theories. Pricing models take into account the contract terms of the securities as well as market-based valuation parameters, such as interest rates, volatility, exchange rates and the credit rating of the counterparty.

Where market-based valuation parameters are not directly observable, management will make a judgment as to its best estimate of that parameter in order to determine a reasonable reflection of how the market would be expected to price the instrument. In exercising this judgment, a variety of tools are used including proxy observable data, historical data, and extrapolation techniques. The best evidence of fair value of a financial instrument at initial recognition is the transaction price unless the instrument is evidenced by comparison with data from observable markets. Any difference between the transaction price and the value based on a valuation technique is not recognized in the statement of comprehensive income on initial recognition. Subsequent gains or losses are only recognized to the extent that it arises from a change in a factor that market participants would consider in setting a price.

The Bank considers that the accounting estimate related to valuation of financial instruments where quoted markets prices are not available is a key source of estimation uncertainty because: (i) it is highly susceptible to change from period to period because it requires management to make assumptions about interest rates, volatility, exchange rates, the credit rating of the counterparty, valuation adjustments and specific feature of the transactions and (ii) the impact that recognizing a change in the valuations would have on the assets reported on its statement of financial position as well as its profit or loss could be material.

Had management used different assumptions regarding the interest rates, volatility, exchange rates, the credit rating of the counterparty and valuation adjustments, a larger or smaller change in the valuation of financial instruments where quoted market prices are not available would have resulted that could have had a material impact on the Bank's reported net income.

The carrying amount of the financial instruments at a fair value is as follows as at December 31, 2011 and 2010:

	December 31, 2011	**December 31, 2010**
Available-for-sale investments	500	2,971

3. ADOPTION OF NEW AND REVISED STANDARDS

In the current year, the Bank has adopted all of the new and revised Standards and Interpretations issued by the IASB and the IFRIC of the IASB that are relevant to its operations and effective for annual reporting periods ending in December 31, 2011. The adoption of these new and revised Standards and Interpretations has not resulted in significant changes to the Bank's accounting policies that have affected the amounts reported for the current or prior years.

The amendments to IAS 32 titled *Classification of Rights Issues* address the classification of certain rights issues denominated in a foreign currency as either an equity instrument or as a financial liability. If the Bank enters into any rights issues within the scope of the amendments in future accounting periods, the amendments to IAS 32 will have an impact on the classification of those rights issues. The revised IAS 32 is effective for annual periods beginning on or after February 1, 2010.

IFRIC 19 provides guidance regarding the accounting for the extinguishment of a financial liability by the issue of equity instruments. To date, the Bank has not entered into transactions of this nature. However, if the Bank enters into any such transactions in the future, IFRIC 19 will affect the required accounting. In particular, under IFRIC 19, equity instruments issued under such arrangements will be measured at their fair value, and any difference between the carrying amount of the financial liability extinguished and the fair value of equity instruments issued will be recognized in profit and loss accounts. IFRIC 19 is effective for annual periods beginning on or after February 1, 2010.

Amendments to IFRS 1 "First-time Adoption of International Financial Reporting Standards" - Limited exemption from comparative IFRS 7 disclosures for the first-time adopters – The amendment provides the same relief to the first-time adopters as was given to current users of IFRS upon adoption of the amendments to IFRS 7. It also clarifies the transition provisions of the amendments to IFRS 7.

IAS 24 "Related party disclosures" (Revised) – The revised IAS 24, issued in November 2009, simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. Previously, an entity controlled or significantly influenced by a government was required to disclose information about all transactions with other entities controlled or significantly influenced by the same government. The revised standard requires disclosure about these transactions only if they are individually or collectively significant. The revised IAS 24 is effective for annual periods beginning on or after January 1, 2011.

Amendment to IFRIC 14, IAS 19 - The limit on a defined benefit assets, minimum funding requirements and their interaction – The new amendment removes unintented consequences arising from the treatment of prepayments where there is a minimum funding requirement. This change results in prepayment of contributions in certain circumstances being recognized as an asset rather than expense. The amendment is effective for annual periods beginning on or after January 1, 2011.

Amendments to IFRS 1 "First-time Adoption of International Financial Reporting Standards" (as part of Improvements to IFRS issued in 2010) – A first-time adopter that changes its accounting policies or its use of IFRS 1 exemptions after publishing a set of IAS 34 interim financial information should explain those changes and include the effects of such changes in its opening reconciliations within the first annual IFRS reporting. The exemption to use a "deemed cost" arising from a revaluation triggered by an event such as a privatization that occurred at or before the date of transition to IFRS is extended to revaluations that occur during the period covered by the first IFRS financial statements. Entities subject to rate regulation are allowed to use previous GAAP carrying amounts of property, plant and equipment or intangible assets as deemed cost on an item-by-item basis. Entities that use this exemption are required to test each item for impairment under IAS 36 at the date of transition.

Amendments to IFRS 3 "Business Combinations" (as part of Improvements to IFRS issued in 2010) – Contingent consideration arrangements arising from business combinations with acquisition dates preceding the application of IFRS 3 (as revised in 2008) are to be accounted for in accordance with the guidance in the previous version of IFRS 3 (as issued in 2004). The choice of measuring non-controlling interests at fair value or at the proportionate share of the acquiree's net assets applies only to instruments that represent present ownership interests and entitle their holders to a proportionate share of the net assets in the event of liquidation. All other components of non-controlling interest are measured at fair value unless another measurement basis is required by IFRS. The application guidance in IFRS 3 applies to all share-based payment transactions that are part of business combination.

Amendments to IFRS 7 "Financial Instruments: Disclosures" (as part of Improvements to IFRS issued in 2010) – The amendments to IFRS 7 clarify the required level of disclosures about credit risk and collateral held and provide relief from disclosures previously required regarding renegotiated loans. The effective date for the application of this amendment is annual periods beginning on or after January 1, 2011.

Amendments regarding to transfers of financial assets increase the disclosure requirements for transactions involving transfers of financial assets. These amendments are intended to provide greater transparency around risk exposures when a financial asset is transferred but the transferor retains some level of continuing exposure in the asset. The amendments also require disclosures where transfers of financial assets are not evenly distributed throughout the period.

Amendments to IAS 1 "Presentation of Financial Statements" (as part of Improvements to IFRS issued in 2010) – The amendments to IAS 1 clarify that an entity may choose to present the required analysis of items of other comprehensive income either in the statement of changes in equity or in the notes to the financial statements. The effective date for the application of the amendment is annual periods beginning on or after January 1, 2011.

IAS 27 "Consolidated and Separate Financial Statements" – Clarifies that the consequential amendments from IAS 27 made to IAS 21, "The effect of changes in foreign exchange rates", IAS 28, "Investments in associates", and IAS 31, "Interests in joint ventures", apply prospectively for annual periods beginning on or after 1 July 2009, or earlier when IAS 27 is applied earlier.

IAS 34 "Interim financial reporting" – The change provides guidance to illustrate how to apply disclosure principles in IAS 34 and add disclosure requirements around:

- The circumstances likely to affect fair values of financial instruments and their classification;
- Transfers of financial instruments between different levels of the fair value hierarchy;
- Changes in classification of financial assets; and
- Changes in contingent liabilities and assets.

IFRIC 13 "Customer loyalty programs" – The meaning of "fair value" is clarified in the context of measuring award credits under customer loyalty programs.

Unless otherwise described above, the new Standards and Interpretations are not expected to significantly affect the Bank's financial statements.

4. STANDARDS AND INTERPRETATIONS ISSUED AND NOT YET ADOPTED

At the date of authorization of these financial statements, other than the Standards and Interpretations adopted by the Bank in advance of their effective dates, the following Interpretations were in issue but not yet effective.

Amendments to IFRS 7 “Financial instruments: Disclosures” on derecognition – This amendment will promote transparency in the reporting of transfer transactions and improve users’ understanding of the risk exposures relating to transfers of financial assets and the effect of those risks on an entity’s financial position, particularly those involving securitization of financial assets. The effective date for the application of the amendment is annual periods beginning on or after July 1, 2011.

Amendments to IFRS 1 “First time adoption of IFRS”, on fixed dates and hyperinflation – These amendments include two changes to IFRS 1, “First-time adoption of IFRS”. The first replaces references to a fixed date of January 1, 2004 with “the date of transition to IFRS”, thus eliminating the need for entities adopting IFRS for the first time to restate derecognition transactions that occurred before the date of transition to IFRS. The second amendment provides guidance on how an entity should resume presenting financial statements in accordance with IFRS after a period when the entity was unable to comply with IFRS because its functional currency was subject to severe hyperinflation. The effective date for the application of the amendment is annual periods beginning on or after July 1, 2011.

Amendment to IAS 12 “Income taxes” on deferred tax – IAS 12 “Income taxes”, currently requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale. It can be difficult and subjective to assess whether recovery will be through use or through sale when the asset is measured using the fair value model in IAS 40 “Investment property”. This amendment therefore introduces an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value. As a result of the amendments, SIC 21 “Income taxes - recovery of revalued non-depreciable assets”, will no longer apply to investment properties carried at fair value. The effective date for the application of the amendment is annual periods beginning on or after January 1, 2012.

Amendment to IAS 1 “Financial statement presentation” regarding other comprehensive income – The main change resulting from these amendments is a requirement for entities to group items presented in “other comprehensive income” (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendments do not address which items are presented in OCI. The effective date for the application of the amendment is annual periods beginning on or after July 1, 2012.

Amendment to IAS 19 “Employee benefits” – These amendments eliminate the corridor approach and calculate finance costs on a net funding basis. The effective date for the application of the amendment is annual periods beginning on or after January 1, 2013.

IFRS 9 “Financial Instruments” issued in November 2009 and amended in October 2010 introduces new requirements for the classification and measurement of financial assets and financial liabilities and for derecognition.

- IFRS 9 requires all recognized financial assets that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* to be subsequently measured at amortized 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 amortized cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair values at the end of subsequent accounting periods;

- The most significant effect of IFRS 9 regarding the classification and measurement of financial liabilities relates to the accounting for changes in fair value of a financial liability (designated as at fair value through profit or loss) attributable to changes in the credit risk of that liability. Specifically, under IFRS 9, for financial liabilities that are designated as at fair value through profit or loss, 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 recognized 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 and loss accounts. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit and loss accounts. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at fair value through profit and loss accounts was recognized in profit and loss accounts. IFRS 9 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted.

The Bank is considering the implications of the standard, the impact on the Bank and the timing of its adoption by the Bank.

IFRS 10 "Consolidated Financial Statements" – IFRS 10 Consolidated Financial Statements provides a single consolidation model that identifies control as the basis for consolidation for all types of entities. The standard sets out requirements for situations when control is difficult to assess, including cases involving potential voting rights, agency relationships, control of specified assets and circumstances in which voting rights are not the dominant factor in determining control. In addition IFRS 10 introduces specific application guidance for agency relationships. The standard also contains accounting requirements and consolidation procedures, which are carried over unchanged from IAS 27. IFRS 10 replaces the consolidation requirements in SIC 12 "Consolidation - Special Purpose Entities" and IAS 27 "Consolidated and Separate Financial Statements" and is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted.

IFRS 11 "Joint Arrangements" – IFRS 11 "Joint Arrangements" improves the accounting for joint arrangements by introducing a principle-based approach that requires a party to a joint arrangement to recognize its rights and obligations arising from the arrangement. The classification of a joint arrangement is determined by assessing the rights and obligations of the parties arising from that arrangement. There are only two types of arrangements provided in the standard - joint operation and joint venture. IFRS 11 also eliminates proportionate consolidation as a method to account for joint ventures. IFRS 11 supersedes IAS 31 "Interests in Joint Ventures" and SIC 13 "Jointly Controlled Entities – Non-monetary Contributions by Venturers" and is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted.

IFRS 12 "Disclosure of Interests in Other Entities" – IFRS 12 "Disclosure of Interests in Other Entities" issued in May 2011 is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. IFRS 12 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted.

IFRS 13 “Fair Value Measurement” – IFRS 13 “Fair Value Measurement” defines fair value, sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value measurements. The standard applies when other IFRS require or permit fair value measurements. It does not introduce any new requirements to measure an asset or a liability at fair value, change what is measured at fair value in IFRSs or address how to present changes in fair value. IFRS 13 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The adoption of the IFRS 13 may have effect on the measurement of the Bank's assets and liabilities accounted for at fair value. Currently, the Bank evaluates possible effect of the adoption of IFRS 13 on its financial position and performance.

IAS 27 (revised 2011) “Separate financial statements” – IAS 27 (revised 2011) includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10. It is effective for annual periods beginning on or after January 1, 2013.

IAS 28 (revised 2011) “Associates and joint ventures” – IAS 28 (revised 2011) includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11. It is effective for annual periods beginning on or after January 1, 2013.

Unless otherwise described above, the new Standards and Interpretations are not expected to significantly affect the Bank’s financial statements.

(In thousands of Azerbaijani Manats)

5. NET INTEREST INCOME

	Year ended December 31, 2011	Year ended December 31, 2010
Interest income comprises:		
Interest income on financial assets recorded at amortized cost:		
Interest income on unimpaired assets	15,213	16,508
Interest income on impaired assets	1,156	795
Interest income on other assets	20	59
Total interest income	**16,389**	**17,362**
Interest income on financial assets recorded at amortized cost comprises:		
Interest income on loans to customers	15,995	16,946
Interest income on due from banks	374	357
Total interest income on financial assets recorded at amortized cost	16,369	17,303
Other interest income	20	59
Total interest income on other financial assets	20	59
Interest expense comprises:		
Interest expense on liabilities recorded at amortized cost:	(10,124)	(11,030)
Total interest expense	**(10,124)**	**(11,030)**
Interest expense on liabilities recorded at amortized cost comprises:		
Interest expense on customer accounts	(9,517)	(9,960)
Interest expense on due to banks and other financial institutions	(551)	(546)
Interest expense on debt securities issued	(56)	(524)
Total interest expense	**(10,124)**	**(11,030)**
Net interest income before provision for impairment losses on interest bearing assets	**6,265**	**6,332**

(In thousands of Azerbaijani Manats)

6. ALLOWANCE FOR IMPAIRMENT LOSSES AND OTHER PROVISIONS

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

	Loans to customers	Due from banks	Guarantees and other commitments	Total
December 31, 2009	**(2,332)**	**(22)**	**(14)**	**(2,368)**
Provision for impairment	(957)	-	-	(957)
Recovery of provisions	-	22	14	36
December 31, 2010	**(3,289)**	**-**	**-**	**(3,289)**
Provision for impairment	(1,040)	-	-	(1,040)
December 31, 2011	**(4,329)**	**-**	**-**	**(4,329)**

7. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprises:

	Year ended December 31, 2011	Year ended December 31, 2010
Dealing differences, net	302	199
Translation differences, net	(49)	38
Total net gain on foreign exchange operations	**253**	**237**

8. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	Year ended December 31, 2011	Year ended December 31, 2010
Fee and commission income:		
Cash operations	1,220	1,197
Settlements	572	553
Plastic card operations	205	119
Foreign exchange operations	22	18
Fees from documentary operations	-	2
Others	17	6
Total fee and commission income	**2,036**	**1,895**
Fee and commission expense:		
Settlements	(299)	(152)
Plastic card operations	(87)	(77)
Cash operations	(17)	(42)
Fees from documentary operations	(1)	-
Others	(5)	(6)
Total fee and commission expense	**(409)**	**(277)**

(In thousands of Azerbaijani Manats)

9. OPERATING EXPENSES

Operating expenses comprise:

	Year ended December 31, 2011	Year ended December 31, 2010
Salaries and employee benefits	3,162	2,342
Depreciation and amortization	1,008	917
Social security costs	735	560
Rent expenses	720	714
Communication expenses	364	401
Security expenses	349	322
Office supplies and printing expenses	331	408
Professional services	304	382
Repair and maintenance expenses	188	243
Advertising and marketing expenses	153	274
Taxes, other than income tax expense	148	170
Business trip expenses	124	120
Utilities expenses	43	36
Insurance expenses	22	32
Other expenses	161	165
Total operating expenses	**7,812**	**7,086**

10. INCOME TAXES

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

The Bank is subject to certain permanent tax differences due to 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, 2011 and 2010 relate mostly to different methods/timing of income and expense recognition as well as to temporary differences generated by taxation bases' differences for certain assets.

The tax legislation of the Republic of Azerbaijan in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result the Bank may be assessed additional taxes, penalties and interest which could be material for these financial statements.

(In thousands of Azerbaijani Manats)

Temporary differences as at December 31, 2011 and 2010 comprise:

	December 31, 2011	December 31, 2010
Deductible temporary differences:		
Other assets	1,670	6,475
Loans to customers	541	164
Other liabilities	266	-
Tax losses carry forwards	161	306
Total deductible temporary differences	**2,638**	**6,945**
Taxable temporary differences:		
Other liabilities	(803)	(3,016)
Property and equipment	-	(2,579)
Total taxable temporary differences	**(803)**	**(5,595)**
Net deferred deductible temporary differences	1,835	1,350
Net deferred tax asset at the statutory tax rate (20%)	367	270
Deferred tax asset not recognized	(130)	(115)
Net deferred tax asset	**237**	**155**

Relationship between tax expenses and accounting profit for the years ended December 31, 2011 and 2010 are explained as follows:

	December 31, 2011	December 31, 2010
(Loss)/profit before income tax	(661)	200
Statutory tax rate	20%	20%
Theoretical tax at the statutory tax rate	132	(40)
Change in deferred tax asset not recognized	15	115
Tax effect of permanent differences	(65)	(68)
Income tax benefit	**82**	**7**
Current income tax expense	-	(79)
Change in the deferred tax asset	82	86
Income tax benefit	**82**	**7**

	December 31, 2011	December 31, 2010
Deferred income tax asset		
Beginning of the period	**155**	**69**
Change in the deferred income tax asset for the period charged to profit or loss accounts	82	86
End of the period	**237**	**155**

(In thousands of Azerbaijani Manats)

11. LOSS PER SHARE

The loss and weighted average number of shares for basic and diluted loss per share comprise:

	Year ended December 31, 2011	Year ended December 31, 2010
(Loss)/ Profit:		
(Loss)/profit for the year	(579)	207
Less:		
Dividends paid to the preferred shareholders	(278)	(299)
Net loss after dividends on preference shares	**(857)**	**(92)**
Weighted average number of shares for basic and diluted loss per share	**57,852**	**46,332**
Loss per share – basic and diluted (AZN)	**(14.81)**	**(1.99)**

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

Cash and balances with the CBRA comprise:

	December 31, 2011	December 31, 2010
Cash in hand	2,599	2,654
Balances with the CBRA	1,583	1,339
Total cash and balances with the CBRA	**4,182**	**3,993**

The balances with the CBRA as at December 31, 2011 and 2010 include AZN 1,102 and AZN 254, respectively, which represent the minimum reserve deposits required by the CBRA. The Bank is required to maintain the reserve balance at the CBRA at all times provided that average daily balance for 30 days period will be eventually higher than required mandatory reserve.

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

	December 31, 2011	December 31, 2010
Cash and balances with the CBRA	4,182	3,993
Due from banks in OECD countries (Note 29)	2,203	3,592
Less minimum reserve deposits with the CBRA	(1,102)	(254)
Total cash and cash equivalents	**5,283**	**7,331**

(In thousands of Azerbaijani Manats)

13. DUE FROM BANKS

Due from banks comprise:

	December 31, 2011	December 31, 2010
Correspondent accounts with other banks	2,719	4,845
Loans and advances to banks	1,517	2,644
Total due from banks	**4,236**	**7,489**

As at December 31, 2011 and 2010, the Bank had AZN 10 thousand and AZN 10 thousand, respectively, as blocked accounts for plastic card operations.

Included in due from banks is accrued interest income of AZN 2 thousand and AZN 4 thousand as at December 31, 2011 and 2010.

During the year ended December 31, 2011, the Bank simultaneously placed with and received short-term funds from various banks of the Republic of Azerbaijan in different currencies. As at December 31, 2011, the Bank placed equivalent of AZN 611 thousand (2010: AZN 1,584 thousand) as deposits with another local bank, which were received from the same bank (see Note 18).

As at December 31, 2011 and 2010, the maximum credit risk exposure on due from banks amounted to AZN 4,236 thousand and AZN 7,489 thousand, respectively.

Currency, liquidity and geographical analysis of due from banks are disclosed in Note 29.

14. LOANS TO CUSTOMERS

Loans to customers comprise:

	December 31, 2011	December 31, 2010
Corporate loans	15,811	18,356
Loans to individuals – consumer loans	37,839	33,536
Loans to individuals – entrepreneurship loans	19,853	16,024
Loans to individuals – car purchase	4,770	7,105
Loans to individuals – plastic cards	3,259	2,640
Less: provision for loan impairment	(4,329)	(3,289)
Total loans to customers	**77,203**	**74,372**

As at December 31, 2011 and 2010, accrued interest income included in loans to customers amounted to AZN 5,129 thousand and AZN 4,138 thousand, respectively.

(In thousands of Azerbaijani Manats)

Information about collateral at December 31, 2011 is as follows:

	Corporate loans	Loans to individuals-consumer loans	Loans to individuals-entrepreneur-ship loans	Loans to individuals-car purchase	Loans to individuals-plastic cards	Total
Unsecured loans	73	2,641	2	-	774	3,490
Loans collateralized by:						
- real estate	12,645	25,432	19,701	28	742	58,548
- vehicle	393	345	20	4,742	42	5,542
- securities	1,871	417	-	-	35	2,323
- deposits	535	1,707	8	-	1,310	3,560
- inventories	18	5	25	-	-	48
- jewellery	-	2,779	17	-	5	2,801
- others	276	4,513	80	-	351	5,220
Less: provision for loan impairment	(1,288)	(2,172)	(605)	(174)	(90)	(4,329)
Total loans to customers	**14,523**	**35,667**	**19,248**	**4,596**	**3,169**	**77,203**

Information about collateral at December 31, 2010 is as follows:

	Corporate loans	Loans to individuals-consumer loans	Loans to individuals-entrepreneur-ship loans	Loans to individuals-car purchase	Loans to individuals-plastic cards	Total
Unsecured loans	74	3,168	14	-	697	3,953
Loans collateralized by:						
- real estate	15,064	22,087	15,768	49	680	53,648
- vehicle	558	392	13	7,056	41	8,060
- securities	1,701	872	-	-	32	2,605
- deposits	549	1,595	25	-	859	3,028
- inventories	24	12	22	-	-	58
- jewellery	-	1,317	-	-	1	1,318
- others	386	4,093	182	-	330	4,991
Less: provision for loan impairment	(724)	(1,780)	(540)	(188)	(57)	(3,289)
Total loans to customers	**17,632**	**31,756**	**15,484**	**6,917**	**2,583**	**74,372**

(In thousands of Azerbaijani Manats)

The analysis by credit quality of loans outstanding at December 31, 2011 is as follows:

	Corporate loans	Loans to individuals-consumer loans	Loans to individuals-entrepreneur-ship loans	Loans to individuals-car purchase	Loans to individuals-plastic cards	Total
Current and not impaired loans						
- Unsecured loans	73	1,570	2	-	571	2,216
Loans collateralized by:						
- real estate	10,101	21,262	15,843	27	586	47,819
- securities	230	178	-	-	5	413
- vehicle	393	335	20	3,312	22	4,082
- deposits	535	1,211	8	-	1,267	3,021
- inventories	1	5	2	-	-	8
- jewellery	-	2,729	17	-	5	2,751
- others	277	4,075	74	-	219	4,645
Total current and not impaired loans	**11,610**	**31,365**	**15,966**	**3,339**	**2,675**	**64,955**
Past due but not impaired loans						
- less than 30 days overdue	81	555	219	148	-	1,003
- 30 to 90 days overdue	908	537	609	158	212	2,424
- 90 to 180 days overdue	1,495	1,479	275	74	77	3,400
- 180 to 360 days overdue	494	2,254	1,695	381	108	4,932
- over 360 days overdue	188	1,396	769	670	163	3,186
Total past due but not impaired loans	**3,166**	**6,221**	**3,567**	**1,431**	**560**	**14,945**
Loans individually determined to be impaired loans						
- less than 30 days overdue	-	165	-	-	-	165
-30 to 90 days overdue	254	-	-	-	-	254
- 90 to 180 days overdue	-	88	320	-	-	408
- over 360 days overdue	781	-	-	-	24	805
Total individually impaired loans	**1,035**	**253**	**320**	**-**	**24**	**1,632**
Gross carrying value of loans	**15,811**	**37,839**	**19,853**	**4,770**	**3,259**	**81,532**
Less provision for loan impairment	(1,288)	(2,172)	(605)	(174)	(90)	(4,329)
Total loans to customers	**14,523**	**35,667**	**19,248**	**4,596**	**3,169**	**77,203**

The Bank applied the portfolio provisioning methodology prescribed by the IAS 39, "Financial Instruments: Recognition and Measurement", and created portfolio provisions for impairment losses that were incurred but have not been specifically identified with any individual loan by the reporting date. The Bank's policy is to classify each loan as "current and not impaired" until a specific objective evidence of impairment of the loan is identified.

(In thousands of Azerbaijani Manats)

The analysis by credit quality of loans outstanding at December 31, 2010 is as follows:

	Corporate loans	Loans to individuals-consumer loans	Loans to individuals-entrepreneur-ship loans	Loans to individuals-car purchase	Loans to individuals-plastic cards	Total
Current and not impaired loans						
- Unsecured loans	-	1,828	13	-	482	2,323
Loans collateralized by:						
- real estate	11,886	18,032	12,717	49	559	43,243
- securities	983	501	-	-	5	1,489
- vehicle	557	389	13	5,914	20	6,893
- deposits	-	1,192	25	-	735	1,952
- inventories	10	10	-	-	-	20
- jewellery	-	1,249	-	-	1	1,250
- others	386	3,710	180	-	267	4,543
Total current and not impaired loans	**13,822**	**26,911**	**12,948**	**5,963**	**2,069**	**61,713**
Past due but not impaired loans						
- less than 30 days overdue	2,039	1,221	689	4	1	3,954
- 30 to 90 days overdue	676	730	336	239	234	2,215
- 90 to 180 days overdue	323	1,610	383	106	114	2,536
- 180 to 360 days overdue	1,203	1,143	650	189	72	3,257
- over 360 days overdue	187	1,011	930	545	149	2,822
Total past due but not impaired loans	**4,428**	**5,715**	**2,988**	**1,083**	**570**	**14,784**
Loans individually determined to be impaired						
- less than 30 days overdue	106	666	66	25	1	864
- over 360 days overdue	-	244	22	34	-	300
Total individually impaired loans	**106**	**910**	**88**	**59**	**1**	**1,164**
Gross carrying value of loans	**18,356**	**33,536**	**16,024**	**7,105**	**2,640**	**77,661**
Less provision for loan impairment	**(724)**	**(1,780)**	**(540)**	**(188)**	**(57)**	**(3,289)**
Total loans to customers	**17,632**	**31,756**	**15,484**	**6,917**	**2,583**	**74,372**

The primary factors that the Bank considers whether a loan is impaired is its overdue status and realisability of related collateral, if any. As a result, the Bank presents above an ageing analysis of loans that are individually determined to be impaired.

Current and not impaired, but renegotiated loans represent the carrying amount of loans that would otherwise be past due or impaired whose terms have been renegotiated. Past due but not impaired loans represent collateralized loans where the fair value of collateral covers the overdue interest and principal repayments. The amount reported as past due but not impaired is the whole balance of such loans, not only the individual instalments that are past due.

(In thousands of Azerbaijani Manats)

The fair value of collateral in respect of loans past due but not impaired and in respect of loans individually determined to be impaired at December 31, 2011 is as follows:

	Corporate loans	Loans to individuals-consumer loans	Loans to individuals-entrepreneur-ship loans	Loans to individuals-car purchase	Loans to individuals-plastic cards	Total
Fair value of collateral - loan past due but not impaired						
- real estate	8,668	9,486	10,319	-	2,562	31,035
- vehicle	-	47	-	2,119	38	2,204
- jewellery	-	56	-	-	-	56
- deposits	-	3,436	-	-	411	3,847
- inventories	44	-	46	-	-	90
- securities	1,635	318	-	-	66	2,019
- unsecured loans	-	74	-	-	7	81
- others	-	105	-	-	16	121
Fair value of collateral - individually impaired loans						
- real estate	-	150	206	-	10	366
- vehicle	-	-	-	-	-	-
- inventories	-	-	-	-	-	-
- securities	1,200	-	-	-	-	1,200
Total	**11,547**	**13,672**	**10,571**	**2,119**	**3,110**	**41,019**

The fair value of collateral in respect of loans past due but not impaired and in respect of loans individually determined to be impaired at December 31, 2010 is as follows:

	Corporate loans	Loans to individuals-consumer loans	Loans to individuals-entrepreneur-ship loans	Loans to individuals-car purchase	Loans to individuals-plastic cards	Total
Fair value of collateral - loan past due but not impaired						
- real estate	8,515	10,793	6,471	-	4,363	30,142
- equipment	45	6	-	1,558	24	1,633
- vehicle	-	69	-	-	-	69
- jewellery	479	1,176	-	-	507	2,162
- deposits	-	2	-	-	-	2
- inventories	1,200	740	-	-	67	2,007
- securities	-	19	-	-	-	19
- others						
Fair value of collateral - individually impaired loans	74	296	107	-	2	479
- real estate	-	3	-	110	-	113
- vehicle	-	-	46	-	-	46
- securities	-	56	-	-	-	56
Total	**10,313**	**13,160**	**6,624**	**1,668**	**4,963**	**36,728**

(In thousands of Azerbaijani Manats)

The fair value of residential real estate at the reporting date was estimated by indexing the values determined by the Bank's credit department staff at the time of loan inception for the average increases in residential real estate prices by city and region. The fair value of other real estate and other assets was determined by the Bank's credit department, using the Bank's and external service organization's guidelines.

The interest rate analysis of loans to customers is disclosed in Note 29. The information on related party balances is disclosed in Note 24.

Economic sector risk concentrations within the customer loan portfolio are as follows:

	December 31, 2011		**December 31, 2010**	
	Amount	**%**	**Amount**	**%**
Individuals	65,719	80.7	59,305	76.4
Trade and service	13,402	16.4	16,050	20.7
Manufacturing	1,743	2.1	1,666	2.1
Agriculture	558	0.7	553	0.7
Construction	20	-	14	-
Others	90	0.1	73	0.1
Total loans to customers (gross)	**81,532**	**100.0**	**77,661**	**100.0**

As at December 31, 2011 and 2010, a significant amount of loans (100% of total portfolio) is granted to companies operating in the Republic of Azerbaijan, which represents a significant geographical concentration in one region.

As at December 31, 2011 and 2010, loans to customers included loans in the amount of AZN 3,591 thousand and AZN 4,942 thousand, respectively, whose terms have been renegotiated. Otherwise, these loans would be impaired.

As at December 31, 2011 and 2010, loans to customers included loan in the amount of AZN 780 thousand and AZN 718 thousand, respectively, granted to one customer, which is not performing since 2009. The collateral pledged against this loan is 41,887 shares of the customer. The fair value of these shares could not be reliably estimated, as the customer has not published its recent financial information about its operations and recent trade prices of the shares are not publicly accessible. The management of the Bank provided AZN 134 thousand and AZN 8 thousand allowance for impairment against this loan as at December 31, 2011 and 2010, respectively. The management of the Bank believes that the market value of the collateral is close to the carrying amount of this loan and allowance provided against the loan is adequate.

As at December 31, 2011 and 2010, a maximum credit risk exposure on loans to customers amounted to AZN 77,203 thousand and AZN 74,372 thousand, respectively.

As at December 31, 2011, the amount of loans to customers that were individually determined to be impaired was AZN 1,632 thousand (2010: AZN 1,164 thousand). As at December 31, 2010 such loans were collateralized by real estate, vehicle and securities with a fair value of AZN 1,566 thousand (2010: AZN 694 thousand).

(In thousands of Azerbaijani Manats)

15. AVAILABILE-FOR-SALE INVESTMENTS

Available-for-sale investments comprise:

	December 31, 2011	December 31, 2010
Equity securities	500	500
Debt securities	-	2,471
Total available-for-sale investments	**500**	**2,971**

	Ownership interest %	December 31, 2011	Ownership interest %	December 31, 2010
Equity securities				
"MilliKart" LLC	10	500	10	500
Total equity securities		**500**		**500**

	Nominal interest rate %	December 31, 2011	Nominal interest rate %	December 31, 2010
Debt securities				
Debt securities of the Azerbaijan Mortgage Fund, under the Central Bank of the Republic of Azerbaijan	-	-	3.25	2,471
Total debt securities		**-**		**2,471**

Management could not reliably estimate the fair value of the Bank's investment in equity of the "MilliKart" LLC. This investment is carried at total cost of AZN 500 thousand (2010: AZN 500 thousand). This investee company has not published its recent financial information about operations, their equity is not quoted and recent trade prices are not publicly accessible. The market for this asset is not liquid, but the management believes potentially interested buyers could be other resident commercial banks and equity investment companies at a price close to its carrying value.

As at December 31, 2011 and 2010, accrued interest income included in investments available-for-sale amounted to AZN nil thousand and AZN 24, respectively.

(In thousands of Azerbaijani Manats)

16. PROPERTY AND EQUIPMENT

As at December 31, 2011 and 2010, property and equipment comprise:

	Buildings	Furniture and fixtures	Computers	Vehicles	Construction in progress	Leasehold improve-ments	Total
At initial cost							
December 31, 2009	**10,292**	**825**	**733**	**927**	**50**	**-**	**12,827**
Additions	1,689	525	279	32	-	32	2,557
Transfer in	50	-	-	-	-	-	50
Transfer out	-	-	-	-	(50)	-	(50)
Disposals	-	(7)	(59)	-	-	-	(66)
December 31, 2010	**12,031**	**1,343**	**953**	**959**	**-**	**32**	**15,318**
Additions	255	310	104	4	-	-	673
Disposals	-	(131)	(174)	(82)	-	-	(387)
December 31, 2011	**12,286**	**1,522**	**883**	**881**	**-**	**32**	**15,604**
Accumulated depreciation							
December 31, 2009	**(1,219)**	**(340)**	**(360)**	**(320)**	**-**	**-**	**(2,239)**
Charge for the year	(515)	(145)	(140)	(85)	-	(18)	(903)
Eliminated on disposal	-	2	56	-	-	-	58
December 31, 2010	**(1,734)**	**(483)**	**(444)**	**(405)**	**-**	**(18)**	**(3,084)**
Charge for the year	(577)	(167)	(161)	(85)	-	(5)	(995)
Eliminated on disposal	-	112	165	82	-	-	359
December 31, 2011	**(2,311)**	**(538)**	**(440)**	**(408)**	**-**	**(23)**	**(3,720)**
Net book value:							
December 31, 2011	**9,975**	**984**	**443**	**473**	**-**	**9**	**11,884**
December 31, 2010	**10,297**	**860**	**509**	**554**	**-**	**14**	**12,234**

As at December 31, 2011 and 2010, included in property and equipment were fully depreciated assets of AZN 99 thousand and AZN 322 thousand, respectively.

(In thousands of Azerbaijani Manats)

17. OTHER ASSETS

Other assets comprise:

	December 31, 2011	December 31, 2010
Other financial assets:		
Settlements on money transfers and plastic cards	421	675
Total other financial assets:	**421**	**675**
Other non-financial assets:		
Repossessed assets	638	24
Prepaid expenses	265	240
Prepaid tax	217	129
Intangible assets	76	79
Prepayments for property and equipment	18	202
Others	39	4
Total other assets	**1,674**	**1,353**

Intangible assets include computer software and licenses.

	Intangible assets
At initial cost	
December 31, 2009	**132**
December 31, 2010	**140**
Additions	10
Disposals	(11)
December 31, 2011	**139**
Accumulated amortization	
December 31, 2009	**(47)**
Amortization for the year	(14)
December 31, 2010	**(61)**
Amortization for the year	(13)
Eliminated on disposal	11
December 31, 2011	**(63)**
Net book value	
December 31, 2011	**76**
December 31, 2010	**79**

(In thousands of Azerbaijani Manats)

18. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

Due to banks and other financial institutions comprise:

	December 31, 2011	December 31, 2010
Recorded at amortized cost:		
Borrowings from other financial institutions	9,904	9,704
Borrowings from other banks	7,929	8,846
Correspondent accounts of other banks	597	639
Total due to banks and other financial institutions	**18,430**	**19,189**

As at December 31, 2011, the Bank had three loans from the CBRA in the amount of AZN 5,000 thousand, AZN 1,250 thousand and AZN 950 thousand with an interest rate of 2.5%, 5.43% and 5.69% per annum, respectively.

As at December 31, 2010, the Bank had three loans from the CBRA in the amount of AZN 5,000 thousand, AZN 1,250 thousand and AZN 450 thousand with an interest rate of 2.5%, 3% and 2.5% per annum, respectively.

As at December 31, 2011, included in the borrowings from other financial institutions are loans received from National Fund for Support of Entrepreneurship ("NFSE"), State Agency on Agricultural Credits under the Ministry of Agriculture ("SAACMA") and also German-Azerbaijan Fund ("GAF").

The Bank signed an agreement with NFSE as a means of support of small and medium-sized entrepreneurs in the Republic of Azerbaijan. Under the agreement with NFSE as at December 31, 2011 and 2010, the Bank received loans totalling to AZN 7,236 thousand and AZN 7,214 thousand with maturity periods of up to 5 years and bearing annual interest rates of 1%. Subsequently, these funds were used by the Bank to issue loans with the same maturity periods to companies and individual entrepreneurs in the Republic of Azerbaijan at annual interest rate of up to 7%. There are no financial covenants with regard to this borrowing that the Bank should comply with.

As at December 31, 2011 and 2010, the Bank received a loan from GAF in the amount of AZN 1,656 thousand and AZN 1,724, respectively, with the average interest rate of 4.83% per annum.

As at December 31, 2011 and 2010, the Bank received a loan from SAACMA in the amount of AZN 1,001 thousand and AZN 765, respectively, with the average interest rate of 2.00% per annum.

As at December 31, 2011 and 2010, accrued interest expense on due to banks and other financial institutions amounted to AZN 12 thousand and AZN 2 thousand, respectively.

During the year ended December 31, 2011, the Bank simultaneously placed with and received short-term funds from various banks of the Republic of Azerbaijan in different currencies. As at December 31, 2011, the Bank placed equivalent of AZN 611 thousand (2010: AZN 1,584 thousand) as deposits with another local bank, which were received from the same bank.

(In thousands of Azerbaijani Manats)

19. CUSTOMER ACCOUNTS

Customer accounts comprise:

	December 31, 2011	December 31, 2010
Time deposits	67,079	67,604
Current and settlement accounts	3,584	2,607
Total customer accounts	**70,663**	**70,211**

As at December 31, 2011 and 2010, accrued interest expense included in customer accounts amounted to AZN 2,797 thousand and AZN 3,089 thousand, respectively.

As at December 31, 2011 and 2010 customer accounts totaling AZN 259 thousand and AZN 117 thousand, respectively, were held as security against guarantees issued by the Bank.

As at December 31, 2011, AZN 17,395 thousand of customer accounts was insured by the State Deposit Insurance Fund of the Republic of Azerbaijan (2010: AZN 20,128 thousand).

Economic sector concentrations within customer accounts are as follows:

	December 31, 2011	December 31, 2010
Analysis by sector:		
Individuals	66,156	64,969
Insurance	3,668	3,569
Service	400	201
Trade	387	618
Construction and real estate	47	31
Agriculture	3	823
Others	2	-
Total customer accounts	**70,663**	**70,211**

20. DEBT SECURITIES ISSUED

Debt securities comprise:

	Maturity date	December 31, 2011	Maturity date	December 31, 2010
Recorded at amortized cost:				
Debt securities issued	August, 2016	634	February, 2011	1,738
Debt securities issued		-	February, 2012	18
Total debt securities issued		**634**		**1,756**

On November, 2011, the Bank issued debt securities that are publicly traded in the Republic of Azerbaijan with nominal value of AZN 620,000 each through a primary placement at the Baku Stock Exchange CJSC. These securities are denominated in AZN, bear an interest rate of 15% per annum and are repayable till August 18, 2016.

(In thousands of Azerbaijani Manats)

As at December 31, 2011 and 2010, accrued interest on debt securities issued amounted to AZN 14 thousand and AZN 25 thousand, respectively.

Subordinated debt securities issued by the Bank are considered as a part of the total capital for capital adequacy purposes according to instructions of the CBRA

21. OTHER LIABILITIES

Other liabilities comprise:

	December 31, 2011	December 31, 2010
Other financial liabilities:		
Accruals for unused vacations and other payables to employees	193	206
Payments on the course of settlement	47	450
Others	48	53
Total other financial liabilities	**288**	**709**
Other non-financial liabilities:		
Payables to State Budget	-	24
Others	114	34
Total other liabilities	**402**	**767**

22. SHARE CAPITAL

As at December 31, 2011, the Bank's authorized, issued and fully paid share capital consisted of 46,332 ordinary shares and 11,520 preference shares with par value of AZN 200 each (2010: 46,332 ordinary shares and 11,520 preferred shares with par value of AZN 200 each). Each ordinary share entitles one vote to the shareholder.

The amount of dividends on preference shares for the year ended December 31, 2011 and 2010 amounted to AZN 278 thousand and AZN 299 thousand, respectively.

The share capital of the Bank in AZN was contributed by shareholders and they are entitled to dividends and any capital distribution. In accordance with the laws of the Republic of Azerbaijan, the shareholders of the Bank should have the following rights: participate in the management of the bank, elect and be elected to its management and executive bodies, collect information related to the activity of the bank, familiarize with annual reports and accounts once a year, request holding the general meeting of shareholders, request amendments to the agenda of the general meeting of shareholders of the Bank, request audit of the activity of the bank and in case of termination of bank's activity, receive a distribution of bank's assets remained after settlements with creditors and payment of calculated but unpaid dividends.

23. COMMITMENTS AND CONTINGENCIES

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

The Bank's maximum exposure to credit loss under contingent liabilities and commitments to extend the credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by contractual amounts of those instruments.

(In thousands of Azerbaijani Manats)

The Bank 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, 2011 and 2010, the nominal or contract amounts were:

	December 31, 2011	December 31, 2010
Contingent liabilities and credit commitments		
Commitments on loans and unused credit lines	1,039	2,842
Guarantees issued and similar commitments	535	784
Total contingent liabilities and credit commitments	**1,574**	**3,626**

Capital commitments

The Bank had no material commitments for capital investments or expenditures outstanding as at December 31, 2011 and 2010.

Legal proceedings

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

Taxation

Provisions of the Republic of Azerbaijan tax legislation are sometimes inconsistent and may have more than one interpretation, which allows the tax authorities to take decisions based on their own arbitrary interpretation of these provisions. In practice, the tax authorities often interpret the tax legislation not in favour of the taxpayers, who have to resort to court proceeding to defend their position against the tax authorities. It should be noted that the tax authorities could use the clarifications issued by the judicial bodies that have introduced the concept of "unjustified tax benefit", "primary commercial goal of transaction" and the criteria of "commercial purpose (substance) of transaction".

Such uncertainty could in particular, be attributed to tax treatment of financial instruments/derivatives and determination of market price of transactions for transfer pricing purposes. It could also lead to temporary taxable differences occurred due to loan impairment provisions and income tax liabilities being treated by the tax authorities as understatement of the tax base. The management of the Bank is confident that applicable taxes have all been accrued and, consequently, creation of respective provisions is not required.

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. Also according to the clarification of the Constitutional Court of the Republic of Azerbaijan, the statute of limitation for tax liabilities may be extended beyond the three year term set forth in the tax legislation, if a court determines that the taxpayers have obstructed or hindered a tax inspection.

(In thousands of Azerbaijani Manats)

Pensions and retirement plans

Employees receive pension benefits from the Republic of Azerbaijan in accordance with the laws and regulations of the country. As at December 31, 2011 and 2010, the Bank was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

24. TRANSACTIONS WITH RELATED PARTIES

Related parties or transactions with related parties, as defined by the IAS 24 "Related Party Disclosures", represent:

(a) Parties that directly, or indirectly through one or more intermediaries: control, or are controlled by, or are under common control with, the Bank (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Bank that gives then significant influence over the Bank and that have joint control over the Bank;
(b) Associates – enterprises on which the Bank has significant influence and which is neither a subsidiary nor a joint venture of the investor;
(c) Members of key management personnel of the Bank or its parent;
(d) Close members of the family of any individuals referred to in (a) or (c);
(e) Parties that are entities controlled, jointly controlled or significantly influenced by, or for which;
(f) Significant voting power in such entity resides with, directly or indirectly, any individual referred to in (c) or (d); or
(g) Post-employment benefit plans for the benefit of employees of the Bank, or of any entity that is a related party of the Bank.

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. Details of transactions between the Bank and other related parties are disclosed below:

	December 31, 2011		**December 31, 2010**	
	Related party balances	**Total category as per financial statements caption**	**Related party balances**	**Total category as per financial statements caption**
Loans to customers		**77,203**		**74,372**
- key management personnel of the Bank	155		175	
- other related parties	303		527	
Allowance for impairment		**(4,329)**		**(3,289)**
- key management personnel of the Bank	(3)		(17)	
- other related parties	(6)		(49)	
Customer accounts		**70,663**		**70,211**
- key management personnel of the Bank	376		113	
- other related parties	1,001		3,085	

(In thousands of Azerbaijani Manats)

	December 31, 2011		December 31, 2010	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Key management personnel compensation:				
Short-term employee benefits	180	**3.897**	195	**2,902**

Included in the statement of comprehensive income for the years ended December 31, 2011 and 2010 are the following amounts that arose due to transactions with related parties:

	Year ended December 31, 2011		Year ended December 31, 2010	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Interest income		**16,389**		**17,362**
- key management personnel of the Bank	14		17	
- other related parties	35		43	
Interest expense		**(10,124)**		**(11,030)**
- key management personnel of the Bank	(21)		(92)	
- other related parties	(8)		(16)	
Provision for impairment losses on interest bearing assets		**(1,040)**		**(921)**
- key management personnel of the Bank	14		(14)	
- other related parties	43		(43)	
Operating expenses excluding salaries and employee benefits		**(3,915)**		**(4,184)**
- key management personnel of the Bank	-		(128)	
- other related parties	(5)		(573)	

25. OPERATING SEGMENTS

The Bank's primary format for reporting segment information is business segments and the secondary format is a geographical segment.

Business segments

The Bank is organized on the basis of two main business segments:

- Retail banking – representing private banking services, private customer current accounts, savings, deposits, investment savings products, credit and debit cards, consumer loans and mortgages;
- Corporate banking – representing direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities, foreign currency and derivative products.

(In thousands of Azerbaijani Manats)

Transactions between the business segments are on normal commercial terms and conditions. Operating expenses and income tax expense are ordinarily reallocated between segments based on the split of the Bank’s interest income. There are no other material items of income or expense between the business segments.

Segment information about these businesses is presented below:

	Retail Banking	**Corporate banking**	**Other segments**	**As at and for the year ended December 31, 2011**
Interest income	8,666	7,723	-	16,389
Interest expense	(9,227)	(897)	-	(10,124)
Provisions for impairment losses on interest bearing assets	(972)	(68)	-	(1,040)
Net gain on foreign exchange operations	-	-	253	253
Fee and commission income	1,313	723	-	2,036
Fee and commission expense	(56)	(353)	-	(409)
Other income	-	-	46	46
Operating income	**(276)**	**7,128**	**299**	**7,151**
Operating expenses	(4,014)	(2,500)	(1,298)	(7,812)
Loss before income tax	(4,290)	4,628	(999)	(661)
Segment assets	67,500	12,925	19,491	99,916
Segment liabilities	46,630	22,386	21,113	90,129
Other segment items:				
Depreciation and amortization charge on property, equipment and intangible assets	-	-	1,008	1,008
Loans to customers	62,679	14,524	-	77,203
Property, equipment and intangible assets	-	-	11,960	11,960
Customer accounts	66,155	4,508	-	70,663

(In thousands of Azerbaijani Manats)

	Retail Banking	Corporate banking	Other segments	As at and for the year ended December 31, 2010
Interest income	9,334	8,028	-	17,362
Interest expense	(9,999)	(1,031)	-	(11,030)
Provisions for impairment losses on interest bearing assets	(578)	(343)	-	(921)
Net gain on foreign exchange operations	-	-	237	237
Fee and commission income	1,249	646	-	1,895
Fee and commission expense	(41)	(236)	-	(277)
Other income	-	-	20	20
Operating income	**(35)**	**7,064**	**257**	**7,286**
Operating expenses	(3,641)	(2,267)	(1,178)	(7,086)
Profit before income tax	(3,676)	4,797	(921)	200
Segment assets	65,641	24,281	12,645	102,567
Segment liabilities	54,670	24,043	13,210	91,923
Other segment items:				
Depreciation and amortization charge on property, equipment and intangible assets	-	-	917	917
Loans to customers	56,740	17,632	-	74,372
Property, equipment and intangible assets	-	-	12,313	12,313
Customer accounts	64,969	5,242	-	70,211

The Bank's assets are mainly located in the Republic of Azerbaijan and major parts of its revenue and net profit arrives from operations in the Republic of Azerbaijan.

26. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments are made in accordance with the requirements of the IAS 32 "Financial Instruments: Disclosure and Presentation" and the IAS 39 "Financial Instruments: Recognition and Measurement". Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale. The estimates presented herein are not necessarily indicative of the amounts the Bank could realize in a market exchange from the sale of its full holdings of a particular instrument.

(In thousands of Azerbaijani Manats)

The fair value of financial assets and liabilities compared with the corresponding carrying amount in the statement of financial position of the Bank is presented below:

	December 31, 2011		December 31, 2010	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
Cash and balances with the CBRA	4,182	4,182	3,993	3,993
Due from banks	4,236	4,236	7,489	7,489
Loans to customers	77,203	77,203	74,372	74,372
Available-for-sale investment	500	500	2,971	2,971
Other financial assets	421	421	675	675
Due to banks and other financial institutions	18,430	18,430	19,189	19,189
Customer accounts	70,663	70,663	70,211	70,211
Debt securities issued	634	634	1,756	1,756
Other financial liabilities	288	288	709	709

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments carried at fair value by valuation technique:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

At December 31, 2011	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets				
Available-for-sale investments:				
“MilliKart” LLC	-	500	-	500
Total available-for-sale investments	**-**	**500**	**-**	**500**

At December 31, 2010	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets				
Available-for-sale investments:				
Debt securities of the Azerbaijan Mortgage Fund, under the Central Bank of the Republic of Azerbaijan	-	2,471	-	2,471
“MilliKart” LLC	-	500	-	500
Total available-for-sale investments	**-**	**2,971**	**-**	**2,971**

(In thousands of Azerbaijani Manats)

The methods and assumptions applied in determining fair values

The estimated fair values of financial instruments have been determined by the Bank, using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value. The Republic of Azerbaijan continues to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. Market quotations may be outdated or reflect distress sale transactions and, therefore, not represent fair values of financial instruments. Management of the bank has used all available market information in estimating the fair value of financial instruments.

Where quoted market prices are not available, the Bank used valuation techniques. The fair value of floating rate instruments that are not quoted in an active market was estimated to be equal to their carrying amount. The fair value of unquoted fixed interest rate instruments was estimated based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

27. REGULATORY MATTERS

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total (12%) and tier 1 capital (6%) to risk weighted assets.

The ratio was calculated according to the principles employed by the CBRA by applying the following risk estimates to the assets and off-balance sheet commitments net of allowances for impairment losses:

Estimate	Description of position
0%	Cash and balances with the CBRA
0%	State debt securities in Azerbaijani Manats
20%	Loans and advances to banks for up to 1 year
100%	Loans and advances to customers (excluding others for residential purposes which are at 50%)
100%	Other assets
50%	Obligations and commitments on unused loans with the initial maturity of over 1 year
100%	Guarantees

Capital amounts and ratios	For capital adequacy purposes	Ratio for capital adequacy purposes	Minimum required ratio
As at December 31, 2011			
Total capital	10,936	12%	12%
Tier 1 capital	9,787	11%	6%
As at December 31, 2010			
Total capital	13,141	13%	12%
Tier 1 capital	11,411	11%	6%

28. CAPITAL MANAGEMENT

The Bank manages its capital to ensure that it will be able to continue as a going concern while maximizing the return to stakeholders through the optimization of the debt and equity balance.

The capital structure of the Bank consists of debt and equity attributable to equity holders of the Bank, comprising of issued capital and retained earnings as disclosed in statement of changes in equity.

The Management Board reviews the capital structure on an ongoing basis. As a part of this review, the Board considers the cost of capital and the risks associated with each class of capital. Based on recommendations of the Board, the Bank balances its overall capital structure through the payment of dividends, new share issues as well as the issue of new debt or the redemption of existing debt.

29. RISK MANAGEMENT POLICIES

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

- Credit risk;
- Liquidity risk;
- Market risk;

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

Credit risk

The Bank takes on exposure to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Exposure to credit risk arises as a result of the Bank's lending and other transactions with counterparties giving rise to financial assets.

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

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

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

(In thousands of Azerbaijani Manats)

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

Maximum Exposure

The Bank’s maximum exposure to on statement of financial position credit risk is generally reflected in the carrying amounts of financial assets on the statement of financial position. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

The maximum credit risk for off-balance items, mainly letters of credit and guarantees, represents the gross amount of the commitment. The Bank’s maximum exposure to off-balance credit risk is disclosed in Note 23 “Contingencies and Commitments”.

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrument failing to perform in accordance with the terms of the contract. The Bank uses the same credit policies in making conditional obligations as it does for on-balance sheet financial instruments through established credit approvals, risk control limits and monitoring procedures.

The following table presents the maximum exposure to credit risk of financial assets and contingent liabilities. For financial assets, the maximum exposure equals to a carrying value of those assets prior to any offset or collateral. For financial guarantees and other contingent liabilities, the maximum exposure to credit risk is the maximum amount the Bank would have to pay if the guarantee was called on or in the case of commitments, if the loan amount was called on.

				December 31, 2011
	Maximum exposure	**Net exposure after offset**	**Collateral Pledged**	**Net exposure after offset and collateral pledged**
Due from banks	4,236	4,236	-	4,236
Loans to customers	77,203	73,643	70,153	3,490
Available-for-sale investments	500	500	-	500
Other financial assets	421	421	-	421

				December 31, 2010
	Maximum exposure	**Net exposure after offset**	**Collateral Pledged**	**Net exposure after offset and collateral pledged**
Due from banks	7,489	7,489	-	7,489
Loans to customers	74,372	71,344	67,391	3,953
Available-for-sale investments	2,971	2,971	-	2,971
Other financial assets	675	675	-	675

(In thousands of Azerbaijani Manats)

Financial assets are graded according to the current credit rating they have been issued by an internationally regarded agency such as Fitch Rating. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade.

The credit rating of the Republic of Azerbaijan according to the international rating agencies in 2011 corresponded to investment level BBB- (2010: BBB-).

The following table details credit ratings of financial assets held by the Organization as at December 31, 2011 and 2010 (this information is prepared for all financial assets that are neither past due nor impaired):

	A	**BBB**	**<BBB**	**RD**	**Not rated**	**December 31, 2011 Total**
Due from banks	1,196	221	1	24	2,794	4,236
Loans to customers	-	-	-	-	77,203	77,203
Available-for-sale investments	-	-	-	-	500	500
Other financial assets	-	-	-	-	421	421

	A	**BBB**	**<BBB**	**RD**	**Not rated**	**December 31, 2010 Total**
Due from banks	3,142	35	110	-	4,202	7,489
Loans to customers	-	-	-	-	74,372	74,372
Available-for-sale investments	-	-	2,471	-	500	2,971
Other financial assets	-	-	-	-	675	675

The banking industry is generally exposed to credit risk through its financial assets and contingent liabilities. Credit risk exposure of the Bank is concentrated within the Republic of Azerbaijan. The exposure is monitored on a regular basis to ensure that the credit limits and credit worthiness guidelines established by the Bank’s risk management policy are not breached.

(In thousands of Azerbaijani Manats)

Geographical concentration

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

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

	The Republic of Azerbaijan	Other non-OECD countries	OECD countries	December 31, 2011 Total
FINANCIAL ASSETS				
Cash and balances with the CBRA	4,182	-	-	4,182
Due from banks	1,611	422	2,203	4,236
Loans to customers	77,191	12	-	77,203
Available-for-sale investments	500	-	-	500
Other financial assets	110	165	146	421
TOTAL FINANCIAL ASSETS	**83,594**	**599**	**2,349**	**86,542**
FINANCIAL LIABILITIES				
Due to banks and other financial institutions	18,430	-	-	18,430
Customer accounts	67,247	344	3,072	70,663
Debt securities issued	634	-	-	634
Other financial liabilities	282	1	5	288
TOTAL FINANCIAL LIABILITIES	**86,593**	**345**	**3,077**	**90,015**
NET POSITION	**(2,999)**	**254**	**(728)**	**(3,473)**

	The Republic of Azerbaijan	Other non-OECD countries	OECD countries	December 31, 2010 Total
FINANCIAL ASSETS				
Cash and balances with the CBRA	3,993	-	-	3,993
Due from banks	3,224	673	3,592	7,489
Loans to customers	74,372	-	-	74,372
Available-for-sale investments	2,971	-	-	2,971
Other financial assets	422	202	51	675
TOTAL FINANCIAL ASSETS	**84,982**	**875**	**3,643**	**89,500**
FINANCIAL LIABILITIES				
Due to banks and other financial institutions	19,189	-	-	19,189
Customer accounts	66,785	201	3,225	70,211
Debt securities issued	1,756	-	-	1,756
Other financial liabilities	658	-	51	709
TOTAL FINANCIAL LIABILITIES	**88,388**	**201**	**3,276**	**91,865**
NET POSITION	**(3,406)**	**674**	**367**	**(2,365)**

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 Assets and Liabilities Management Committee ("ALMC") controls these types of risks by means of maturity analysis, determining the Bank's strategy for the next financial period. Current liquidity is managed by the ALMC, which deals in the money markets for current liquidity support and cash flow optimization.

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

An analysis of the liquidity and interest rate risks is presented in the following table. The tables have been drawn up to detail:

(i) The remaining contractual maturity of non-derivative financial liabilities based on the undiscounted cash flows of financial liabilities (both interest and principal cash flows) based on the earliest date on which the Bank can be required to pay, and

(ii) The expected maturity for non-derivative financial assets based on the undiscounted contractual maturities of the financial assets including interest that will be earned on those assets except where the Bank anticipates that the cash flow will occur in a different period.

(In thousands of Azerbaijani Manats)

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity Undefined	December 31, 2011 Total
FINANCIAL ASSETS								
Due from banks	3.33%	2	1,515	-	-	-	-	1,517
Loans to customers	20.98%	7,732	12,370	33,325	18,036	5,740	-	77,203
Total interest bearing financial assets		**7,734**	**13,885**	**33,325**	**18,036**	**5,740**	**-**	**78,720**
Cash and balances with the CBRA		3,080	-	-	-	-	1,102	4,182
Due from banks		2,719	-	-	-	-	-	2,719
Available-for-sale investments		-	-	-	-	-	500	500
Other financial assets		421	-	-	-	-	-	421
Total financial assets		**13,954**	**13,885**	**33,325**	**18,036**	**5,740**	**1,602**	**86,542**
FINANCIAL LIABILITIES								
Due to banks and other financial institutions	4.51%	697	1,884	10,501	4,640	111	-	17,833
Customer accounts	14.10%	5,322	5,696	28,662	22,751	4,648	-	67,079
Debt securities issued	15.00%	14	-	-	620	-	-	634
Total interest bearing financial liabilities		**6,033**	**7,580**	**39,163**	**28,011**	**4,759**	**-**	**85,546**
Due to banks and other financial institutions		597	-	-	-	-	-	597
Customer accounts		3,584	-	-	-	-	-	3,584
Other financial liabilities		288	-	-	-	-	-	288
Total financial liabilities		**10,502**	**7,580**	**39,163**	**28,011**	**4,759**	**-**	**90,015**
Liquidity gap		3,452	6,305	(5,838)	(9,975)	981		
Interest sensitivity gap		1,701	6,305	(5,838)	(9,975)	981		
Cumulative interest sensitivity gap		**1,701**	**8,006**	**2,168**	**(7,807)**	**(6,826)**		

(In thousands of Azerbaijani Manats)

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity Undefined	December 31, 2010 Total
FINANCIAL ASSETS								
Due from banks	4.02%	1,060	-	1,584	-	-	-	2,644
Loans to customers	22.39%	9,680	12,446	30,772	17,350	4,124	-	74,372
Available-for-sale investments	3.25%	2,471	-	-	-	-	-	2,471
Total interest bearing financial assets		**13,211**	**12,446**	**32,356**	**17,350**	**4,124**	**-**	**79,487**
Cash and balances with the CBRA		3,739	-	-	-	-	254	3,993
Due from banks		4,845	-	-	-	-		4,845
Available-for-sale investments		-	-	-	-	-	500	500
Other financial assets		675	-	-	-	-		675
Total financial assets		**22,470**	**12,446**	**32,356**	**17,350**	**4,124**	**754**	**89,500**
FINANCIAL LIABILITIES								
Due to banks and other financial institutions	5.02%	3	-	4,189	14,245	113	-	18,550
Customer accounts	16.59%	6,645	7,105	29,140	24,312	402	-	67,604
Debt securities issued	18.00%	25	1,713	-	18	-	-	1,756
Total interest bearing financial liabilities		**6,673**	**8,818**	**33,329**	**38,575**	**515**	**-**	**87,910**
Due to banks and other financial institutions		639	-	-	-	-	-	639
Customer accounts		2,607	-	-	-	-	-	2,607
Other financial liabilities		709	-	-	-	-	-	709
Total financial liabilities		**10,628**	**8,818**	**33,329**	**38,575**	**515**	**-**	**91,865**
Liquidity gap		11,842	3,628	(973)	(21,225)	3,609		
Interest sensitivity gap		6,538	3,628	(973)	(21,225)	3,609		
Cumulative interest sensitivity gap		**6,538**	**10,166**	**9,193**	**(12,032)**	**(8,423)**		

The majority of the Bank’s interest earning assets and interest bearing liabilities are at fixed rates of interest.

Asset and liability maturity periods and the ability to replace interest liabilities at an acceptable cost when they mature are crucial in determining the Bank’s liquidity and its susceptibility to fluctuations in interest rates and exchange rates.

A further analysis of the liquidity and interest rate risks is presented in the following tables in accordance with IFRS 7. The amounts disclosed in these tables do not correspond to the amounts recorded on the statement of financial position as the presentation below includes a maturity analysis for financial liabilities that indicates the total remaining contractual payments (including interest payments), which are not recognized in the statement of financial position under the effective interest rate method.

(In thousands of Azerbaijani Manats)

The maturity analysis of financial liabilities at December 31, 2011 is as follows:

	Demand and less than 1 month	From 1 to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Due to banks and other financial institutions	720	1,957	10,774	4,914	111	18,476
Customer accounts	6,051	7,088	33,354	31,434	5,251	83,178
Debt securities issued	22	16	71	977	-	1,086
Total interest bearing financial liabilities	**6,793**	**9,061**	**44,199**	**37,325**	**5,362**	**102,740**
Due to banks and other financial institutions	597	-	-	-	-	597
Customer accounts	3,584	-	-	-	-	3,584
Other financial liabilities	288	-	-	-	-	288
Total potential future payments for financial obligations	**11,262**	**9,061**	**44,199**	**37,325**	**5,362**	**107,209**

The maturity analysis of financial liabilities at December 31, 2010 is as follows:

	Demand and less than 1 month	From 1 to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Due to banks and other financial institutions	47	93	4,518	14,649	113	19,420
Customer accounts	7,482	8,628	34,105	29,469	1,459	81,143
Debt securities issued	51	1,759	2	19	-	1,831
Total interest bearing financial liabilities	**7,580**	**10,480**	**38,625**	**44,137**	**1,572**	**102,394**
Due to banks and other financial institutions	639	-	-	-	-	639
Customer accounts	2,607	-	-	-	-	2,607
Other financial liabilities	709	-	-	-	-	709
Total potential future payments for financial obligations	**11,535**	**10,480**	**38,625**	**44,137**	**1,572**	**106,349**

Customer accounts are classified in the above analysis based on contractual maturities. However, in accordance with Azerbaijani Civil Code, individuals have a right to withdraw their deposits prior to maturity, if they forfeit their right to accrued interest.

(In thousands of Azerbaijani Manats)

Market risk

Market risk covers interest rate risk, currency risk and other pricing risks to which the Bank is exposed. There have been no changes as to the way the Bank measures risk or to the risk it is exposed in 2011 and 2010.

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

The majority of the Bank's loan contracts and other financial assets and liabilities bear fixed interest rates. The Bank monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

Interest rate risk

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

The following table presents a sensitivity analysis of interest rate risk, which has been determined based on "reasonably possible changes in the risk variable". The level of these changes is determined by management and is contained within the risk reports provided to key management personnel.

Impact on (loss)/profit before tax:

	As at December 31, 2011		As at December 31, 2010	
	Interest rate +1%	Interest rate -1%	Interest rate +1%	Interest rate -1%
Financial assets:				
Due from banks	15	(15)	26	(26)
Loans to customers	772	(772)	744	(744)
Available-for-sale investments	-	-	25	(25)
Financial liabilities:				
Due to banks and other financial institutions	(178)	178	(186)	186
Customer accounts	(671)	671	(676)	676
Debt securities issued	(6)	6	(18)	18
Net impact on (loss)/profit before tax	**(68)**	**68**	**(85)**	**85**

Currency risk

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

The Management Board sets limits on the level of exposure by currencies, which give the Bank an opportunity to minimize losses from significant currency rates fluctuations toward its national currency. The ALMC performs daily monitoring of the Bank's open currency position with the aim to match the requirement of the CBRA. These limits also comply with the minimum requirements of the CBRA.

(In thousands of Azerbaijani Manats)

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

	AZN	USD	EUR	Other	December 31, 2011 Total
FINANCIAL ASSETS					
Cash and balances with the CBRA	2,786	580	790	26	4,182
Due from banks	-	2,451	1,685	100	4,236
Loans to customers	51,845	24,880	478	-	77,203
Available-for-sale investments	500	-	-	-	500
Other financial assets	58	232	61	70	421
TOTAL FINANCIAL ASSETS	**55,189**	**28,143**	**3,014**	**196**	**86,542**
FINANCIAL LIABILITIES					
Due to banks and other financial institutions	15,460	1,311	1,659	-	18,430
Customer accounts	41,763	25,926	2,974	-	70,663
Debt securities issued	634	-	-	-	634
Other financial liabilities	280	8	-	-	288
TOTAL FINANCIAL LIABILITIES	**58,137**	**27,245**	**4,633**	**-**	**90,015**
OPEN CURRENCY POSITION	**(2,948)**	**898**	**(1,619)**	**196**	

	AZN	USD	EUR	Other	December 31, 2010 Total
FINANCIAL ASSETS					
Cash and balances with the CBRA	2,690	781	480	42	3,993
Due from banks	2	2,165	5,256	66	7,489
Loans to customers	43,462	30,133	777	-	74,372
Available-for-sale investments	2,971	-	-	-	2,971
Other financial assets	21	579	51	24	675
TOTAL FINANCIAL ASSETS	**49,146**	**33,658**	**6,564**	**132**	**89,500**
FINANCIAL LIABILITIES					
Due to banks and other financial institutions	14,693	2,772	1,724	-	19,189
Customer accounts	35,940	29,876	4,393	2	70,211
Debt securities issued	-	1,756	-	-	1,756
Other financial liabilities	277	432	-	-	709
TOTAL FINANCIAL LIABILITIES	**50,910**	**34,836**	**6,117**	**2**	**91,865**
OPEN CURRENCY POSITION	**(1,764)**	**(1,178)**	**447**	**130**	

(In thousands of Azerbaijani Manats)

Currency risk sensitivity

The following tables detail the Bank's sensitivity to a 10 percent increase and decrease in the USD and EUR against the AZN. 10 percent is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Bank where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

	As at December 31, 2011		As at December 31, 2010	
	AZN/USD +10%	AZN/USD -10%	AZN/USD +10%	AZN/USD -10%
Net impact on (loss)/profit before tax	90	(90)	(118)	118

	As at December 31, 2011		As at December 31, 2010	
	AZN/EURO +10%	AZN/EURO -10%	AZN/EURO +10%	AZN/EURO -10%
Net impact on (loss)/profit before tax	(162)	162	45	(45)

Price risks

Price risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market. The Bank is exposed to price risks of its products that are subject to general and specific market fluctuations.

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

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