"Yapi Kredi Bank Azerbaijan" CJSC
Consolidated Financial Statements

Year ended 31 December 2012
Together with Independent Auditors' Report

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Independent auditors' report

To the Shareholders and Board of Directors of Yapi Kredi Bank CJSC -

We have audited the accompanying consolidated financial statements of Yapi Kredi Bank CJSC and its subsidiary, which comprise the consolidated statement of financial position as at 31 December 2012, and the consolidated statements of comprehensive income, of changes in equity and of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Yapi Kredi Bank CJSC and its subsidiary as at 31 December 2012, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young Holdings (CIS) B.V.

13 March 2013

Consolidated statement of financial position

As at 31 December 2012

(Thousands of Azerbaijani Manats)

	Notes	*2012*	*2011 (as restated)*	*2010 (as restated)*
Assets				
Cash and cash equivalents	6	44,149	80,882	101,131
Amounts due from credit institutions	7	3,950	15,353	18,786
Loans to customers	8	148,951	126,091	70,094
Investment securities available-for-sale	9	6,075	5,311	11,861
Investment securities pledged under repurchase agreements	14	-	3,001	-
Property and equipment	10	10,482	4,427	4,136
Intangible assets	11	3,144	1,102	429
Other assets	13	4,183	2,959	902
Total assets		**220,934**	**239,126**	**207,339**
Liabilities				
Amounts due to credit institutions	14	49,422	72,421	79,077
Amounts due to customers	15	104,845	104,341	74,422
Current income tax liabilities	12	340	178	-
Deferred income tax liabilities	12	491	593	404
Other liabilities	13	3,182	1,265	1,240
Total liabilities		**158,280**	**178,798**	**155,143**
Equity				
Share capital	16	46,811	38,110	31,610
Retained earnings		15,843	22,218	20,586
Total equity		**62,654**	**60,328**	**52,196**
Total liabilities and equity		**220,934**	**239,126**	**207,339**

Signed and authorised for release on behalf of the Management Board of the Bank:

Altan Shenturk — Chief Executive Officer / General Director

Osman Gunaydin — Chief Operations Officer

Khalida Hasanova — Chief of Accounting Control Department

13 March 2013

The accompanying notes on pages 5 to 37 are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December 2012

(Thousands of Azerbaijani Manats)

	Notes	*2012*	*2011 (as restated)*
Interest income			
Loans to customers		17,832	11,562
Amounts due from credit institutions		389	945
Investment securities		246	487
Cash and cash equivalents		70	70
		18,537	**13,064**
Interest expense			
Amounts due to customers		(1,948)	(291)
Amounts due to credit institutions		(1,222)	(1,381)
		(3,170)	**(1,672)**
Net interest income		**15,367**	**11,392**
Impairment charge on interest bearing assets	8	(1,057)	(79)
Net interest income after impairment charge on interest bearing assets		**14,310**	**11,313**
Fee and commission income	18	5,298	4,484
Fee and commission expense	18	(993)	(832)
Net gains / (losses) from foreign currency			
- dealing		3,345	2,420
- translation differences		(80)	145
Other income		6	-
Non-interest income		**7,576**	**6,217**
Personnel expenses	19	(8,073)	(4,897)
General and administrative expenses	20	(7,494)	(2,847)
Depreciation and amortization	10, 11	(2,738)	(1,078)
Reversal of other impairment and provisions		(200)	-
Non-interest expense		**(18,505)**	**(8,822)**
Profit before income tax expense		**3,381**	**8,708**
Income tax expense	12	(1,055)	(576)
Profit for the year		**2,326**	**8,132**
Other comprehensive income for the year		-	-
Total comprehensive income for the year		**2,326**	**8,132**

The accompanying notes on pages 5 to 37 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2012

(Thousands of Azerbaijani Manats)

	Share capital	*Retained earnings*	*Total*
31 December 2010 (as previously issued)	**31,610**	**18,886**	**50,496**
Effect of restatements (Note 2)	-	1,700	1,700
31 December 2010 (as restated)	**31,610**	**20,586**	**52,196**
Total comprehensive income for the year (as restated)	-	8,132	8,132
Capitalization of 2010 profit (Notes 12 and 16)	6,500	(6,500)	-
31 December 2011 (as restated)	**38,110**	**22,218**	**60,328**
Total comprehensive income for the year	-	2,326	2,326
Capitalization of 2011 profit (Notes 12 and 16)	8,701	(8,701)	-
31 December 2012	**46,811**	**15,843**	**62,654**

The accompanying notes on pages 5 to 37 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2012

(Thousands of Azerbaijani Manats)

	Notes	*2012*	*2011*
Cash flows from operating activities			
Interest received		18,655	12,964
Interest paid		(2,613)	(1,617)
Fees and commissions received		5,268	4,472
Fees and commissions paid		(967)	(832)
Realized gains less losses from dealing in foreign currencies		3,345	2,420
Other income received		6	-
Personnel expenses paid		(7,728)	(4,904)
Other operating expenses paid		(7,459)	(2,924)
Cash flows from operating activities before changes in operating assets and liabilities		**8,507**	**9,579**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		10,821	3,042
Loans to customers		(23,455)	(55,608)
Other assets		(606)	(1,218)
Net increase /(decrease) in operating liabilities			
Amounts due to credit institutions		(23,245)	(6,710)
Amounts due to customers		193	29,918
Other liabilities		1,311	122
Net cash flows used in operating activities before income tax		**(26,474)**	**(20,875)**
Income tax paid	12	(995)	(209)
Net cash used in operating activities		**(27,469)**	**(21,084)**
Cash flows from investing activities			
Purchase of investment securities available-for-sale		-	(103,804)
Proceeds from redemption of investment securities available-for-sale		2,239	107,377
Purchase of property and equipment		(8,264)	(2,149)
Acquisition of intangible assets	11	(3,159)	(734)
Net cash (used in)/from investing activities		**(9,184)**	**690**
Effect of exchange rates changes on cash and cash equivalents		(80)	145
Net decrease in cash and cash equivalents		**(36,733)**	**(20,249)**
Cash and cash equivalents, beginning		**80,882**	**101,131**
Cash and cash equivalents, ending	6	**44,149**	**80,882**

The accompanying notes on pages 5 to 37 are an integral part of these consolidated financial statements.

(Thousands of Azerbaijani Manats)

1. Principal activities

Yapi Kredi Bank Azerbaijan (the "Yapi Kredi Bank") was incorporated and is domiciled in the Republic of Azerbaijan. Yapi Kredi Bank Azerbaijan is a closed joint-stock company limited by shares and was set up in accordance with Azerbaijani regulations.

The Yapi Kredi Bank's principal business activity is commercial and retail banking operations within the Republic of Azerbaijan. The Yapi Kredi Bank has operated under a full banking licence issued by the Central Bank of the Republic of Azerbaijan (the "CBA") since 11 January 2000 under registration number 243. The Yapi Kredi Bank participates in the state deposit insurance scheme, which was introduced by the Azeri Law, "Insurance of individual deposits in the Republic of Azerbaijan" dated 29 December 2006. The State Deposit Insurance Fund guarantees full repayment of deposits of individuals in the amount up to AZN 30. The Yapi Kredi Bank's registered address is 32/12 Jafar Jabbarli street Baku, AZ1065, The Republic of Azerbaijan.

On 31 July 2007, Yapi Kredi Bank Azerbaijan registered its wholly-owned brokerage subsidiary, Yapi Kredi Invest LLC (the "Subsidiary") with the Ministry of Justice of the Republic of Azerbaijan. The Subsidiary commenced its operations in February 2008 and is involved in dealing and brokerage operations. The official address of the Subsidiary is: Jafar Jabbarli street 32/12, Baku, AZ1065, The Republic of Azerbaijan.

The consolidated financial statements include the financial statements of the Yapi Kredi Bank and its subsidiary (collectively referred to as the "Bank").

The Bank has 10 branches (2011: 9 branches) within the Republic of Azerbaijan. The Bank had 384 employees at 31 December 2012 (2011: 182).

Shareholder	*2012* %	*2011* %
Yapı ve Kredi Bankası A.Ş.	99.8	99.8
YK Yatirim Menkul Degerler A.Ş.	0.1	0.1
YK Lease A.Ş.	0.1	0.1
Total	**100.0**	**100.0**

Yapı ve Kredi Bankası A.Ş. ("YKB"), an entity established in Turkey, is the ultimate parent of the Bank. YKB's shares have been traded on the Istanbul Stock Exchange ("ISE") since 1987. As at 31 December 2012, 18.20% of the shares of YKB are publicly traded (31 December 2011 – 18.20%). The remaining 81.80% is owned by Koç Finansal Hizmetler A.Ş. ("KFS"). The ultimate shareholders of KFS are UniCredito Italiano SPA and Koç Holding, with 50% ownership each.

2. Basis of preparation

General

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

The Azerbaijani Manat is the reporting and functional currency of the Bank as the majority of the transactions are denominated, measured, or funded in Azerbaijani Manat. Transactions in other currencies are treated as transactions in foreign currencies. These consolidated financial statements are presented in thousands of Azerbaijani Manats ("AZN"), except per share amounts and unless otherwise indicated.

The consolidated financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. For example, available-for-sale securities have been measured at fair value.

(Thousands of Azerbaijani Manats)

2. Basis of preparation (continued)

Restatements

In the course of preparation of the consolidated financial statements as of and for the year ended 31 December 2012, errors were identified in its 2011 and 2010 previously issued consolidated financial statements relating to the establishment of loan loss allowance in accordance with IFRS and its related deferred tax effect. The Bank has corrected those errors by restating the comparative information as of 31 December 2011 and 2010 and for the year ended 31 December 2011. The errors are described below:

In 2011 and 2010 the Bank established its allowance for loan impairment based on the Central Bank of Azerbaijan requirements and not IFRS. As a result the Allowance for Loan Impairment is overstated, and consequently the Loans to Customers is understated, by AZN2,952 and AZN2,104 as of 31 December 2011 and 2010, respectively; and Impairment Charge on Interest Bearing Assets is overstated by AZN848 for the year ended 31 December 2011. The related deferred tax effect is an understatement of Deferred Tax Liabilities by AZN574 and AZN404 as of 31 December 2011 and 2010, respectively; and understatement of Income Tax Expense by AZN170 for the year ended 31 December 2011. Net effect of these adjustments resulted to an understatement of Retained Earnings by AZN2,378 and AZN1,700 as of 31 December 2011 and 2010, respectively; and understatement of Profit for the Year ended 31 December 2011 by AZN678.

The effect of restatements on the consolidated statement of financial position as of 31 December 2011 and consolidated statement of comprehensive income for the year then ended is presented in the table below:

Consolidated Statement of Financial Position	As previously reported	Effect of restatements	As Restated
Loans to customers	123,139	2,952	126,091
Deferred tax liabilities	19	574	593
Retained earnings	19,840	2,378	22,218
Consolidated Statement of Comprehensive Income			
Impairment charge on interest bearing assets	927	(848)	79
Income tax expense	406	170	576
Profit for the year	7,454	678	8,132

The effect of restatements on the consolidated statement of financial position as of 31 December 2010 is presented in the table below:

Consolidated Statement of Financial Position	As previously reported	Effect of restatements	As Restated
Loans to customers	67,990	2,104	70,094
Deferred tax liabilities	-	404	404
Retained earnings	18,886	1,700	20,586

3. Summary of accounting policies

Changes in accounting policies

The Bank has adopted the following amended IFRS during the year. The principal effects of these changes are as follows:

Amendments to IFRS 7 "Financial Instruments: Disclosures"
The Amendments were issued in October 2010 and are effective for annual periods beginning on or after 1 July 2011. The amendment requires additional disclosure about financial assets that have been transferred to enable the users of the Bank's consolidated financial statements to evaluate the risk exposures relating to those assets. The amendment affects disclosure only and has no impact on the Bank's financial position or performance.

Other amendments resulting from Improvements to the following standards did not have any impact on the accounting policies, financial position or performance of the Bank:

- IAS 12 *Income Taxes (Amendment)* – Deferred Taxes: Recovery of Underlying Assets
- IFRS 1 *First-Time Adoption of International Financial Reporting Standards (Amendment) – Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopter*

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Basis of consolidation

Subsidiaries, which are those entities in which the Bank has an interest of more than one half of the voting rights, or otherwise has power to exercise control over their operations, are consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Bank and are no longer consolidated from the date that control ceases. All intra-group transactions, balances and unrealized gains on transactions between group companies are eliminated in full; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Bank.

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. Losses are attributed to the non-controlling interests even if that results in a deficit balance.

If the Bank loses control over a subsidiary, it derecognizes the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests, the cumulative translation differences, recorded in equity; recognizes the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in profit or loss and reclassifies the parent's share of components previously recognized in other comprehensive income to profit or loss.

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognized initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Bank determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Bank commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

'Day 1' profit

Where the transaction price in a non-active market is different to the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets, the Bank immediately recognizes the difference between the transaction price and fair value (a 'Day 1' profit) in the consolidated statement of comprehensive income. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognized in the consolidated statement of comprehensive income when the inputs become observable, or when the instrument is derecognized.

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 the consolidated statement of comprehensive income when the loans and receivables are derecognized or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified as loans and receivables. After initial recognition available-for-sale 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 as part of current profit and loss. However, interest calculated using the effective interest method is recognized as current profit and loss.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Financial assets (continued)

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.

Offsetting

Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the consolidated statement of financial position.

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 or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the CBA, excluding obligatory reserves, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

Repurchase and reverse repurchase agreements and securities lending

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the consolidated statement of financial position and, in case the transferee has the right by contract or custom to sell or repledge them, reclassified as securities pledged under sale and repurchase agreements. The corresponding liability is presented within amounts due to credit institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as amounts due from credit institutions or loans to customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

Securities lent to counterparties are retained in the consolidated statement of financial position. Securities borrowed are not recorded in the consolidated statement of financial position, unless these are sold to third parties, in which case the purchase and sale are recorded within gains less losses from trading securities in the consolidated statement of comprehensive income. The obligation to return them is recorded at fair value as a trading liability.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to credit institutions and amounts due to customers. After initial recognition, borrowings are subsequently measured at amortized cost using the effective interest method.

Gains and losses are recognized in the consolidated statement of comprehensive income when the borrowings are derecognized as well as through the amortization process.

Leases

Operating – Bank as lessee

Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognized as expenses on a straight-line basis over the lease term and included into General and administrative expenses.

Impairment of financial assets

Amounts due from credit institutions and loans to customers

For amounts due from credit institutions and loans to customers carried at amortized cost, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the consolidated statement of comprehensive income. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the consolidated statement of comprehensive income.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

Available-for-sale financial investments

For available-for-sale 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 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 the consolidated statement of comprehensive income– is reclassified from other comprehensive income as current profit and loss. Impairment losses on equity investments are not reversed through current profit and 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 the consolidated statement of comprehensive income. 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 the consolidated statement of comprehensive income, the impairment loss is reversed through the consolidated statement of comprehensive income.

Financial assets

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.

The accounting treatment of such restructuring is as follows:

- if the currency of the loan has been changed the old loan is derecognized and the new loan is recognized;
- if the loan restructuring is not caused by the financial difficulties of the borrower the Bank uses the same approach as for financial liabilities described below;
- if the loan restructuring is due to the financial difficulties of the borrower and the loan is impaired after restructuring, the Bank recognizes the difference between the present value of the new cash flows discounted using the original effective interest rate and the carrying amount before restructuring in the provision charges for the period. In case loan is not impaired after restructuring the Bank recalculates the effective interest rate.

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.

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized where:

- the rights to receive cash flows from the asset have expired;
- the Bank has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- the Bank either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Bank`s continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and / or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank`s continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities

Financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the consolidated statement of comprehensive income.

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit and guarantees. Financial guarantees are initially recognized in the consolidated financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortized premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the consolidated statement of comprehensive income. The premium received is recognized in the consolidated statement of comprehensive income on a straight-line basis over the life of the guarantee.

Taxation

Income taxes have been provided for in the consolidated financial statements in accordance with Azerbaijan legislation enacted or substantively enacted by the end of the reporting period.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting date.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

There are also various operating taxes, that are assessed on the Bank`s activities. These taxes are included as a component of other operating expenses.

Property and equipment

Property and equipment are carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	2012	*2011*	*2010*
	Years	*Years*	*Years*
Leasehold improvements	10	10	10
Furniture and fixtures	4 - 5	4	4
Computers and office equipment	4	4	4
Motor vehicles	4	4	4

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Property and equipment (continued)

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

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

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic lives of 1 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortization periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

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 amount of obligation can be made.

Share capital

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognized as additional paid-in capital.

Segment reporting

The Bank's segmental reporting is based on the following operating segments: Retail banking and Corporate banking.

Contingencies

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

Recognition of income and expenses

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized.

Interest and similar income and expense

For all financial instruments measured at amortized c ost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original effective interest rate applied to the new carrying amount.

Fee and commission income

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

Fee income earned from services that are provided over a certain period of time

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income and other advisory fees. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognized as an adjustment to the effective interest rate on the loan.

Fee income from providing transaction services

Fees arising from negotiating or participating in the negotiation of a transaction for a third party are recognized on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognized after fulfilling the corresponding criteria.

Dividend income

Revenue is recognized when the Bank's right to receive the payment is established.

Foreign currency translation

Transactions in foreign currencies are initially recorded in the functional currency converted at the rate of exchange ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognized in the consolidated statement of comprehensive income as net gains (losses) from foreign currency translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the CBA exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The Bank used the following official exchange rates at 31 December 2012 and 2011 in the preparation of these consolidated financial statements:

	31 December 2012	31 December 2011	31 December 2010
1 US Dollar	AZN 0.7850	AZN 0.7865	AZN 0.7979
1 Euro	AZN 1.0377	AZN 1.0178	AZN 1.0560

Future changes in accounting policies

Standards and interpretations issued but not yet effective

IFRS 9 "Financial Instruments"
IFRS 9, as issued, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but *Amendments to IFRS 9 mandatory Effective Date of IFRS 9 and Transition Disclosures*, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The Bank will quantify the effect of the adoption of the first phase of IFRS 9 in conjunction with the other phases, when issued, to present a comprehensive picture.

IFRS 10 Consolidated Financial Statements
IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgement to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in IAS 27. In addition IFRS 10 introduces specific application guidance for agency relationships. IFRS 10 replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. It also includes the issues raised in SIC-12 Consolidation — *Special Purpose Entities*. It is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. Currently the Bank evaluates possible effect of the adoption of IFRS 10 on its financial position and performance.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Future changes in accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

IFRS 11 Joint Arrangements
IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method. 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 1 January 2013. Earlier application is permitted. The Bank expects that adoption of IFRS 11 will have no effect on its financial position and performance.

IFRS 12 Disclosure of Interests in Other Entities
IFRS 12 is effective for annual periods beginning on or after 1 January 2013. IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. In particular, the Bank will need to disclose more information about the consolidated and unconsolidated structured entities with which it is involved or which it has sponsored. However, the standard will have no impact on Bank's financial position or performance.

IFRS 13 Fair Value Measurement
IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. IFRS 13 is effective for annual periods beginning on or after 1 January 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 Separate Financial Statements (as revized in 2011)
As a consequence of the new IFRS 10 and IFRS 12, what remains of IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The amendment becomes effective for annual periods beginning on or after 1 January 2013. The Bank expects that these amendments will have no impact on the Bank's financial position.

IAS 28 Investments in Associates and Joint Ventures (as revised in 2011)
As a consequence of the new IFRS 11 and IFRS 12. IAS 28 has been renamed IAS 28 Investments in Associates and Joint Ventures, and describes the application of the equity method to investments in joint ventures in addition to associates. The amendment becomes effective for annual periods beginning on or after 1 January 2013. The Bank expects that these amendments will have no impact on the Bank's financial position.

Amendments to IAS 19 Employee Benefits
The IASB has published amendments to IAS 19 Employee Benefits, effective for annual periods beginning on or after 1 January 2013, which involve major changes to the accounting for employee benefits, including the removal of the option for deferred recognition of changes in pension plan assets and liabilities (known as the "corridor approach"). In addition, these amendments will limit the changes in the net pension asset (liability) recognized in profit or loss to net interest income (expense) and service costs. The Bank expects that these amendments will have no impact on the Bank's financial position.

Amendments to IAS 1 Changes to the Presentation of Other Comprehensive Income
The amendments to IAS 1 change the grouping of items presented in other comprehensive income. Items that could be reclassified (or recycled) to profit or loss at a future point in time (for example, net losses or gains on available-for-sale financial assets) would be presented separately from items that will never be reclassified (for example, revaluation of buildings). The amendment affects presentation only and has no impact on the Bank's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 July 2012.

Amendments to IFRS 7 Disclosures – Offsetting Financial assets and Financial Liabilities
These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognized financial instruments that are set off in accordance with *IAS 32 Financial Instruments: Presentation*. The disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreements, irrespective of whether they are set off in accordance with IAS 32. These amendments will not impact the Banks' financial position or performance and will become effective for annual periods beginning on or after 1 January 2013.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Future changes in accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

Amendments to IAS 32 – Offsetting Financial Assets and Financial Liabilities
These amendments clarify the meaning of "currently has a legally enforceable right to set-off". It will be necessary to assess the impact to the Bank by reviewing settlement procedures and legal documentation to ensure that offsetting is still possible in cases where it has been achieved in the past. In certain cases, offsetting may no longer be achieved. In other cases, contracts may have to be renegotiated. The requirement that the right of set-off be available for all counterparties to the netting agreement may prove to be a challenge for contracts where only one party has the right ot offset in the event of default.

The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. While many settlement systems are expected to meet the new criteria, some may not. As the impact of the adoption depends on the Bank's examination of the operational procedures applied by the central clearing houses and settlement systems it deals with to determine if they meet the new criteria, it is not practical to quantify the effects.

These amendments become effective for annual periods beginning on or after 1 January 2014.

Amendment to IFRS 1 – Government loans
These amendments require first-time adopters to apply the requirements of *IAS 20 Accounting for Government Grants and Disclosure of Government Assistance*, prospectively to government loans existing at the date of transition to IFRS. The amendment will have no impact on the Bank.

Improvements to IFRS
The amendments are effective for annual periods beginning on or after 1 January 2013. They will not have an impact on the Bank.

- *IFRS 1 First-time Adoption of International Financial Reporting Standards:* This improvement clarifies that an entity that stopped applying IFRS in the past and chooses, or is required, to apply IFRS, has the option to re-apply IFRS 1. If IFRS 1 is not re-applied, an entity must retrospectively restate its financial statements as if it had never stopped applying IFRS.
- *IAS 1 Presentation of Financial Statements*: This improvement clarifies the difference between voluntary additional comparative information and the minimum required comparative information. Generally, the minimum required comparative information is the previous period.
- *IAS 16 Property Plant and Equipment*: This improvement clarifies that major spare parts and servicing equipment that meet the definition of property; plant and equipment are not inventory.
- *IAS 32 Financial Instruments, Presentation*: This improvement clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with IAS 12 Income Taxes.
- *IAS 34 Interim Financial Reporting:* The amendment aligns the disclosure requirements for total segment assets with total segment liabilities in interim financial statements. This clarification also ensures that interim disclosures are aligned with annual disclosures.

4. Significant accounting judgments and estimates

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognized in the consolidated financial statements. The most significant use of judgments and estimates are as follows:

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its experienced judgment to estimate the amount of any impairment loss in cases where a borrower is in 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 the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or 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 and receivables. The Bank uses its experienced judgment to adjust observable data for a group of loans or receivables to reflect current circumstances.

(Thousands of Azerbaijani Manats)

4. Significant accounting judgments and estimates (continued)

Determination of collateral value

Management monitors market value of collateral on a regular basis. Management uses its experienced judgement or independent opinion to adjust the fair value to reflect the current circumstances. The amount and collateral required depend on the assessment of credit risk of the counterparty.

Initial recognition of related party transactions

In the normal course of business the Bank enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis.

Determination of collateral value

Management monitors market value of collateral on a regular basis. Management uses its experienced judgement or independent opinion to adjust the fair value to reflect the current circumstances. The amount and collateral required depend on the assessment of credit risk of the counterparty.

5. Segment information

For management purposes, the Bank is organized into two operating segments based on products and services as follows:

Retail banking	Principally handling individual customers' deposits, and providing consumer loans, overdrafts, credit cards facilities and funds transfer facilities.
Corporate banking	Principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance, as explained in the table below, is measured differently from profit or loss in the consolidated financial statements. Income taxes are managed on a Bank's basis and are not allocated to operating segments.

Transfer prices between operating segments are on an arm's length basis in a manner similar to transactions with third parties.

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Bank's total revenue in 2012 or 2011.

The following tables present revenue, expenses and profit information regarding the Bank's operating segments.

2012	*Retail banking*	*Corporate banking*	*Unallocated*	*Total*
Revenue				
Interest income	7,620	10,671	246	**18,537**
Fee and commission income	2,207	3,091	-	**5,298**
Non-interest income	1,363	1,908	-	**3,271**
Total revenue	**11,190**	**15,670**	**246**	**27,106**
Interest expense	(410)	(2,760)	-	**(3,170)**
Fee and commission expense	(129)	(864)	-	**(993)**
Impairment charge on interest bearing assets	(338)	(719)	-	**(1,057)**
Non-interest expense	(7,526)	(10,737)	(242)	**(18,505)**
Segment results	**2,787**	**590**	**4**	**3,381**
Income tax expense	(433)	(621)	(1)	**(1,055)**
Profit / (loss) for the year	**2,354**	**(31)**	**3**	**2,326**
Other segment information				
Capital expenditure	4,905	7,026	337	**12,268**

(Thousands of Azerbaijani Manats)

5. Segment information (continued)

2011	*Retail banking*	*Corporate banking*	*Unallocated*	*Total*
Revenue				
Interest income	2,979	9,598	487	**13,064**
Fee and commission income	1,062	3,422	-	**4,484**
Non-interest income	608	1,957	-	**2,565**
Total revenue	**4,649**	**14,977**	**487**	**20,113**
Interest expense	(64)	(1,608)	-	**(1,672)**
Fee and commission expense	(32)	(800)	-	**(832)**
Impairment charge on interest bearing assets	(28)	(51)	-	**(79)**
Non-interest expense	(2,012)	(6,481)	(329)	**(8,822)**
Segment results	**2,513**	**6,037**	**158**	**8,708**
Income tax expense	(128)	(416)	(32)	**(576)**
Profit for the year	**2,385**	**5,621**	**126**	**8,132**
Other segment information				
Capital expenditure	634	2,147	101	**2,882**

Geographic information

The Bank's revenues from third party customers for the years ended 31 December 2012 and 2011 are generated in the Republic of Azerbaijan.

6. Cash and cash equivalents

Cash and cash equivalents comprise:

	2012	*2011*	*2010*
Cash on hand	12,214	6,936	7,037
Current accounts with the Central Bank of the Republic of Azerbaijan	12,509	24,291	28,768
Current accounts with other credit institutions	15,804	49,655	60,140
Loans to credit institutions up to 90 days	3,622	-	-
Time deposits with credit institutions up to 90 days	-	-	5,186
Cash and cash equivalents	**44,149**	**80,882**	**101,131**

Non-cash transaction performed by the Bank during 2012 is represented by the capitalization of its 2011 profit (2011: 2010 profit, 2010: 2009 profit) and corresponding issuance of share capital for AZN 8,701 (2011: AZN 6,500, 2010: AZN 4,401).

As at 31 December 2012, loans up to 90 days were issued to resident bank with effective annual interest rate of 6.25%.

As at 31 December 2010, time deposits up to 90 days were placed with parent company, Yapi Kredi A.Ş., with effective annual interest rate of 5.5%.

7. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2012	*2011*	*2010*
Obligatory reserve with the Central Bank of the Republic of Azerbaijan	3,942	2,965	412
Blocked accounts	8	9	32
Time deposits for more than 90 days	-	12,379	12,922
Short term loans to credit institutions	-	-	5,420
Amounts due from credit institutions	**3,950**	**15,353**	**18,786**

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

(Thousands of Azerbaijani Manats)

7. Amounts due from credit institutions (continued)

As at 31 December 2011, inter-bank time deposits include AZN 12,379 (2010: AZN 11,969) placed with one (2010: one) resident bank with an average effective annual interest rate of 6.6% (2010: 9.6%).

Blocked accounts represent security deposits placed to secure settlement operations through Master Card.

As at 31 December 2010, short term loans issued to credit institutions of AZN 5,420 comprised loans to two resident banks with average effective annual interest rate of 4.1%.

As of 31 December 2012 the Bank had two (2011 – nil, 2010: nil) deposit placements with a local bank in the total amount of USD 12,600 and the same counterparty bank had two placements with the Bank for the total amount of AZN 9,892. Annual interest rate for placements made and deposits received comprised of 5%. All contracts mature in January 2013. These placements represent currency swaps which were netted off for presentation purposes in the consolidated statement of financial position as of 31 December 2012.

8. Loans to customers

Loans to customers comprise:

	2012	*2011 (as restated)*	*2010 (as restated)*
Corporate lending	89,523	99,668	60,498
Consumer lending	47,624	17,798	4,907
Small business lending	11,043	8,166	4,522
Residential mortgages	2,078	719	348
Gross loans to customers	**150,268**	**126,351**	**70,275**
Less – Allowance for impairment	(1,317)	(260)	(181)
Loans to customers	**148,951**	**126,091**	**70,094**

Allowance for impairment of loans to customers

A reconciliation of the allowance for impairment of loans to customers by class is as follows:

	Corporate lending 2012	*Small business lending 2012*	*Consumer lending 2012*	*Total 2012*
At 1 January 2012	189	4	67	**260**
Impairment charge for the year	338	28	691	**1,057**
At 31 December 2012	**527**	**32**	**758**	**1,317**
Individual impairment	299	-	161	**460**
Collective impairment	228	32	597	**857**
	527	**32**	**758**	**1,317**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**562**	**-**	**320**	**882**

	Corporate lending 2011 (as restated)	*Small business lending 2011 (as restated)*	*Consumer lending 2011 (as restated)*	*Total 2011 (as restated)*
At 1 January 2011	138	15	28	**181**
Impairment charge/(reversal) for the year	51	(11)	39	**79**
At 31 December 2011	**189**	**4**	**67**	**260**
Individual impairment	-	-	-	**-**
Collective impairment	189	4	67	**260**
	189	**4**	**67**	**260**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	-	-	-	-

(Thousands of Azerbaijani Manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers (continued)

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2012, comprised AZN 129 (2011: nil, 2010: nil).

In accordance with the CBA requirements, loans may only be written off with the approval of the Supervisory Board and, in certain cases, with the respective decision of the Court.

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

- for corporate lending - charges over real estate and trade receivables, third party guarantees;
- for consumer lending - cash, charges over credited consumer appliances and mortgages over residential properties;
- for auto lending - cash and liens over vehicles.

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

Concentration of loans to customers

As at 31 December 2012, the Bank had a concentration of loans represented by AZN 37,458 or 25% of gross loan portfolio (2011: AZN 51,346 or 40.6%, 2010: AZN 43,287 or 61.6%) due from the ten largest third party borrowers (2011: twelve largest third party borrowers, 2010: thirteen largest third party borrowers).

Loans have been extended to the following types of customers:

	2012	*2011*	*2010*
Private companies	83,527	90,449	53,746
Individuals	60,745	26,683	9,777
State companies	5,996	9,219	6,752
Total gross loans to customers	**150,268**	**126,351**	**70,275**

Loans are made within Azerbaijan in the following industry sectors:

	2012	*2011*	*2010*
Individuals	60,745	26,683	9,777
Trading enterprises	33,899	47,060	23,672
Real estate construction	31,989	23,056	29,986
Manufacturing	23,635	29,552	6,840
Total gross loans to customers	**150,268**	**126,351**	**70,275**

(Thousands of Azerbaijani Manats)

9. Investment securities available for sale

Investment securities comprise:

	2012	2011	2010
Treasury bills of the Ministry of Finance of the Republic of Azerbaijan	3,165	2,087	2,037
Bonds issued by the Mortgage Fund of the Republic of Azerbaijan	2,850	3,164	3,162
Notes issued by the CBA	-	-	6,001
Corporate bonds	-	-	601
Total debt securities	**6,015**	**5,251**	**11,801**
Corporate unquoted shares	60	60	60
Total available-for-sale securities	**6,075**	**5,311**	**11,861**

Nominal interest rates and maturities of debt securities are as follows:

	2012		2011		2010	
	Annual interest rate	Maturity	Annual interest rate	Maturity	Annual interest rate	Maturity
Treasury bills of the Ministry of Finance of the Republic of Azerbaijan	4.5%-5.0%	Apr'13-Apr'14	4.0% - 5.0%	Feb'12-Apr'14	3.75% - 9.5%	Feb-Mar'11
Bonds issued by the Mortgage Fund of the Republic of Azerbaijan	3.25%	Dec'19	3.25%	Dec'19	3.25%	Dec'19
Notes issued by the CBA	-	-	-	-	1.0%	Jan'11
Corporate bonds	-	-	-	-	14.0%	Jul'11

At 31 December 2012, 2011 and 2010 the equity investment securities available-for-sale are:

Name	Nature of business	Country of registration	Share of ownership	Fair value 2012	2011	2010
Baku Stock Exchange	**Stock exchange**	**Republic of Azerbaijan**	5.00%	60	60	60
Total				**60**	**60**	**60**

The Bank's management believes that the fair value of this investment does not differ significantly from its carrying value.

(Thousands of Azerbaijani Manats)

10. Property and equipment

The movements in property and equipment were as follows:

	Leasehold improvements	*Computers and office equipment*	*Furniture and fixtures*	*Motor vehicles*	*Total*
Cost					
31 December 2011	**4,306**	**2,376**	**637**	**132**	**7,451**
Additions	3,821	3,502	356	2	**7,681**
Disposals	(1)	-	(9)	-	**(10)**
31 December 2012	**8,126**	**5,878**	**984**	**134**	**15,122**
Accumulated depreciation	**(1,184)**	**(1,281)**	**(457)**	**(102)**	**(3,024)**
31 December 2011					
Depreciation charge	(573)	(749)	(278)	(21)	**(1,621)**
Disposals	-	-	5	-	**5**
31 December 2012	**(1,757)**	**(2,030)**	**(730)**	**(123)**	**(4,640)**
Net book value:					
31 December 2011	**3,122**	**1,095**	**180**	**30**	**4,427**
31 December 2012	**6,369**	**3,848**	**254**	**11**	**10,482**

	Leasehold improvements	*Computers and office equipment*	*Furniture and fixtures*	*Motor vehicles*	*Total*
Cost					
31 December 2010	**3,589**	**1,889**	**540**	**132**	**6,150**
Additions	717	488	104	-	**1,309**
Disposals	-	(1)	(7)	-	**(8)**
31 December 2011	**4,306**	**2,376**	**637**	**132**	**7,451**
Accumulated depreciation					
31 December 2010	**(744)**	**(851)**	**(340)**	**(79)**	**(2,014)**
Depreciation charge	(440)	(431)	(123)	(23)	**(1,017)**
Disposals	-	1	6	-	**7**
31 December 2011	**(1,184)**	**(1,281)**	**(457)**	**(102)**	**(3,024)**
Net book value:					
31 December 2010	**2,845**	**1,038**	**200**	**53**	**4,136**
31 December 2011	**3,122**	**1,095**	**180**	**30**	**4,427**

11. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Total*
Cost			
31 December 2011	**114**	**1,139**	**1,253**
Additions	2,457	702	**3,159**
31 December 2012	**2,571**	**1,841**	**4,412**
Accumulated amortization			
31 December 2011	**(20)**	**(131)**	**(151)**
Amortization charge	(1,002)	(115)	**(1,117)**
31 December 2012	**(1,022)**	**(246)**	**(1,268)**
Net book value:			
31 December 2011	**94**	**1,008**	**1,102**
31 December 2012	**1,549**	**1,595**	**3,144**

(Thousands of Azerbaijani Manats)

11. Intangible assets (continued)

	Licenses	*Computer software*	*Total*
Cost			
31 December 2010	**27**	**492**	**519**
Additions	87	647	734
31 December 2011	**114**	**1,139**	**1,253**
Accumulated amortization			
31 December 2010	**(7)**	**(83)**	**(90)**
Amortisation charge	(13)	(48)	(61)
31 December 2011	**(20)**	**(131)**	**(151)**
Net book value:			
31 December 2010	**20**	**409**	**429**
31 December 2011	**94**	**1,008**	**1,102**

12. Taxation

The corporate income tax expense comprises:

	2012	*2011 (as restated)*
Current tax charge	(1,157)	(387)
Deferred tax reversal / (origination) of temporary differences	102	(189)
Income tax expense	**(1,055)**	**(576)**

Standard corporate income tax rate for companies (including banks) comprised 20% for 2012 and 2011.

In accordance with the Law of the Republic of Azerbaijan on enhancement of the activities of banks, insurance and reinsurance companies (N710-IIIQ and dated 28 October 2008), financial institutions are exempt from payment of profit tax with effect from 1 January 2009 for a period of three consecutive years, if the current year's profit is capitalized. As a result, based on the shareholders' meeting held on 19 March 2010, the Bank decided to utilise the tax exemption in accordance with the law for the years 2009 – 2011.

In May 2012, the Bank has finalized the capitalization of its 2011 year profit and increased its share capital by AZN 8,701 (2011: AZN 6,500), representing 435,023,488 (2011: 324,968,952) shares at AZN 0.02 per share.

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	2012	*2011 (as restated)*
Profit before income tax expense	**3,381**	**8,708**
Statutory tax rate	20%	20%
Theoretical income tax expense at the statutory rate	**(676)**	**(1,742)**
Tax effect of items which are not deductible or assessable for taxation purposes:		
Non-deductible expenses	(379)	(332)
Tax effect of profit subject to the three-year tax exemption	-	1,498
Income tax expense	**(1,055)**	**(576)**

Current income tax liability as at 31 December 2012 amounted to AZN 340 (2011: AZN 178, 2010: nil).

(Thousands of Azerbaijani Manats)

12. Taxation (continued)

Deferred tax assets and liabilities as at 31 December and their movements for the respective years comprise:

	31 December 2010 (as restated)	*Recognized in comprehensive income (as restated)*	*31 December 2011 (as restated)*	*Recognized in comprehensive income*	*31 December 2012*
Tax effect of temporary differences:					
Loans to customers	(404)	(170)	(574)	(196)	(770)
Property and equipment	-	(19)	(19)	(25)	(44)
Intangible assets	-	-	-	9	9
Other liabilities	-	-	-	320	320
Other assets	-	-	-	(6)	(6)
Deferred tax (liability) / asset	**(404)**	**(189)**	**(593)**	**102**	**(491)**

13. Other assets and liabilities

Other assets comprise:

	2012	*2011*	*2010*
Amounts in the course of settlement	334	78	42
Less – Allowance for impairment of other assets	(14)	(14)	-
Total other financial assets	**320**	**64**	**42**
Prepayments	2,308	703	360
Property and equipment not-in use	1,427	840	-
Prepaid taxes other than income tax	117	1,275	491
Other non-financial assets	11	77	9
Total other non-financial assets	**3,863**	**2,895**	**860**
Total other assets	**4,183**	**2,959**	**902**

As at 31 December 2012 prepayments of AZN 2,308 (2011: AZN 703, 2010: AZN 360), primarily comprise of advance payments for purchase of property and equipment, advertisement, insurance and rent.

Other liabilities comprise:

	2012	*2011*	*2010*
Payables on acquisition of property and equipment	556	-	-
Other payables	484	234	311
Other financial liabilities	182	99	-
Total other financial liabilities	**1,222**	**333**	**311**
Accrued employee costs	963	618	625
Deferred income	779	303	290
Provisions	200	-	-
Other non-financial liabilities	18	11	14
Total other non-financial liabilities	**1,960**	**932**	**929**
Total other liabilities	**3,182**	**1,265**	**1,240**

Accrued employee costs include bonuses for employees based on the financial performance of the Bank of AZN 554 (2011: AZN 336, 2010: AZN 380) and an accrual for unused vacations of AZN 409 (2011: AZN 282, 2010: AZN 245).

At 31 December 2012, deferred income included deferred revenue of AZN 779 (2011: AZN 303, 2010: AZN 290) which was primarily comprised of fee for issuance of plastic cards and obtaining guarantee and letter of credit.

(Thousands of Azerbaijani Manats)

14. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2012	*2011*	*2010*
Demand deposits	20,497	33,188	79,077
Time deposits	28,925	36,232	-
Repurchase agreements	-	3,001	-
Amounts due to credit institutions	**49,422**	**72,421**	**79,077**

The Bank pays interest on correspondent account balances at the rates ranging from 3.00% p.a. to 4.50% p.a. for USD and from 1.25% p.a. to 2.00% p.a. for euro (2011: from 0.75% p.a. to 3.75% p.a. for USD, from 0.2% p.a. to 1.75% p.a. for euro, 2010: from 3% p.a. to 4.8% p.a for USD, from 0.2% p.a. to 1.75% p.a. for Euro).

At 31 December 2012, the Bank had demand deposit with one (2011: one, 2010: three) resident bank with balance above AZN 5,000. The aggregate balance of this account was AZN 5,679 at 31 December 2012 (2011: AZN 8,788, 2010: AZN 51,739), which represented 28% (2011: 26%, 2010: 65%) of total demand deposits balance.

As at 31 December 2012, inter-bank time deposits include AZN 28,925 (2011: AZN 36,232, 2010: nil) placed with two resident and one non-resident bank (2011: with two non-resident banks) with the average annual interest rate in the range from 3.08% p.a. to 6.00% p.a. (2011: from 1.39% p.a. to 1.43% p.a., 2010: nil).

During 2011, the Bank entered into reverse repurchase agreements with the maturity of ten days. Subjects of these agreements were treasury bills issued by the Ministry of Finance with a fair value of AZN 3,001 with maturity from March 2012 to February 2014 at yield in range from 4% p.a. to 5% p.a. Repurchase agreements matured during January 2012.

15. Amounts due to customers

The amounts due to customers include the following:

	2012	*2011*	*2010*
Current accounts	56,897	68,159	59,316
Time deposits	47,948	36,182	15,106
Amounts due to customers	**104,845**	**104,341**	**74,422**
Held as security against guarantees	**134**	**162**	**192**

At 31 December 2012, amounts due to customers of AZN 45,312 or 43% (2011: AZN 64,104 or 62%, 2010: AZN 29,352 or 39.4%) of total amounts due to customers were due to ten largest customers.

The average annual interest rate on term deposits of individual customers outstanding at 31 December 2012 comprised 5.00% (2011: 3.48%, 2010: 2.87%), while the average annual interest rate on term deposits of legal entities outstanding at 31 December 2012 was 4.59% (2011: 3.6%, 2010: 2.94%).

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

	2012	*2011*	*2010*
Private enterprises	66,944	79,916	62,593
Individuals	36,646	20,964	11,431
Public organizations	1,255	3,461	398
Amounts due to customers	**104,845**	**104,341**	**74,422**

An analysis of customer accounts by economic sector follows:

	2012	*2011*	*2010*
Trade	49,804	70,687	49,804
Individuals	36,646	20,964	11,431
Insurance	10,415	587	1,041
Transport and communication	3,525	6,341	6,706
Real estate constructions	3,200	2,301	5,042
Public organizations	1,255	3,461	398
Amounts due to customers	**104,845**	**104,341**	**74,422**

(Thousands of Azerbaijani Manats)

16. Equity

All ordinary shares have a nominal value of AZN 0.02 per share and rank equally. Each share carries one vote.

As discussed in Note 12, on 29 May 2012, the Bank completed the capitalization of AZN 8,701 (2011: AZN 6,500) from its 2011 profit (2011: 2010 profit) by charging retained earnings and issuance of 435,023,488 (2011: 324,968,952) additional ordinary shares.

Movements in shares outstanding, issued and fully paid were as follows:

	Number of ordinary shares	*Nominal amount (in full amount)*	*Total*
31 December 2010	**1,580,542,754**	**0.02**	**31,610**
Increase in share capital through capitalization of 2010 profit	324,968,952	0.02	6,500
31 December 2011	**1,905,511,706**	**0.02**	**38,110**
Increase in share capital through capitalization of 2011 profit	435,023,488	0.02	8,701
31 December 2012	**2,340,535,194**	**0.02**	**46,811**

17. Commitments and contingencies

Operating environment

Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks. The future stability of the Azerbaijan economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

The Azerbaijani economy has been affected by the global financial crisis. Despite some indications of recovery there continues to be uncertainty regarding further economic growth, access to capital and cost of capital, which could negatively affect the Bank's future financial position, results of operations and business prospects. To the extent that information is available, the Bank has reflected revised estimates of expected future cash flows in its impairment assessment.

While management believes it is taking appropriate measures to support the sustainability of the Bank's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Bank's results and financial position in a manner not currently determinable.

Legal

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Bank.

Taxation

Tax and social contribution legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management interpretation of such legislation and changes, including the new law allowing financial institutions to be exempt from payment of profit tax starting 1 January 2009 (for 3 consequent years) if the current year profit is capitalized, as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. As such, additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three years including the year of review. The last tax audit of the Bank was completed in July 2009 and covered the period from January 2006 to March 2009.

Management believes that as at 31 December 2012 its interpretation of the relevant legislation is appropriate and that the Bank's tax and social contribution position will be sustained.

(Thousands of Azerbaijani Manats)

17. Commitments and contingencies (continued)

Commitments and contingencies

As at 31 December, the Bank's commitments and contingencies comprised the following:

	2012	*2011*	*2010*
Credit related commitments			
Undrawn loan commitments	45,328	14,069	15,026
Guarantees issued	12,973	12,411	15,399
Letters of credit	3,967	2,107	1,697
	62,268	**28,587**	**32,122**
Operating lease commitments			
Not later than 1 year	1,515	176	134
Later than 1 year but not later than 5 years	7,145	-	60
Later than 5 years	3,082	-	-
	11,742	**176**	**194**
Commitments and contingencies (before deducting collateral)	**74,010**	**28,763**	**32,316**
Less – Cash held as security against guarantees (Note 15)	(134)	(162)	(192)
Commitments and contingencies	**73,876**	**28,601**	**32,124**

Most of the outstanding guarantee letters as at 31 December 2012, 2011 and 2010 represent guarantees issued to clients for the latter's performance on delivering goods and services, and tender guarantees issued to clients as a pledge of their intent to participate in a bidding tender, announced by various institutions.

18. Net fee and commission income

Net fee and commission income comprises:

	2012	*2011*
Cash collection	2,012	1,244
Settlements operations	1,545	2,075
Plastic card operation	849	445
Agent activities	518	94
Guarantees and letters of credit	320	502
Other	54	124
Fee and commission income	**5,298**	**4,484**
Plastic cards operations	(631)	(348)
Settlements operations	(283)	(263)
Cash operations	(54)	(36)
Securities operations	(14)	(77)
Other	(11)	(108)
Fee and commission expense	**(993)**	**(832)**
Net fee and commission income	**4,305**	**3,652**

19. Personnel expenses

Personnel expenses comprise:

	2012	*2011*
Salaries and bonuses	(6,257)	(3,923)
Social security costs	(867)	(512)
Other employment expenses	(949)	(462)
Total personnel expenses	**(8,073)**	**(4,897)**

(Thousands of Azerbaijani Manats)

20. General and administrative expenses

General and administrative expenses comprise:

	2012	*2011*
Occupancy and rent	(1,843)	(1,013)
Marketing and advertising	(1,311)	(83)
Legal and consultancy	(1,272)	(139)
Security	(681)	(522)
Repairs and Maintenance	(603)	(341)
Communications	(566)	(408)
Membership	(167)	(18)
Office supplies	(140)	(90)
Utilities	(132)	(91)
Operating taxes other than income taxes	(51)	(33)
Insurance	(39)	(44)
Other	(689)	(65)
General and administrative expenses	**(7,494)**	**(2,847)**

21. Risk management

Introduction

Risk is inherent in the Bank's activities and managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's sustainability and profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk, market risk and operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

Risk management structure

The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles.

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Bank.

Risk Committee

The Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Risk Management Unit

The Risk Management Unit is responsible for implementing and maintaining risk related procedures to ensure an independent control process.

Risk Controlling Unit

The Risk Controlling Unit is responsible for monitoring compliance with risk principles, policies and limits, across the Bank. Each business group has a decentralized unit which is responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This unit also ensures the complete capture of the risks in risk measurement and reporting systems.

(Thousands of Azerbaijani Manats)

21. Risk management (continued)

Introduction (continued)

Bank Treasury

Bank Treasury is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank.

Internal Audit

Risk management processes throughout the Bank are audited annually by the internal audit function that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Risk measurement and reporting systems

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worst case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risks types and activities.

Information compiled from all the businesses is examined and processed in order to analyze, control and identify early risks. On a regular basis detailed reporting of industry and customer risks takes place.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry.

In order to avoid excessive concentrations of risks, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

The Bank makes available to its customers guarantees which may require that the Bank make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies.

The maximum exposure to credit risk for the components of the consolidated statement of financial position before the effect of mitigation through the use of master netting and collateral agreements and after deducting any allowance for impairment is best represented by their carrying amounts.

Where financial instruments are recorded at fair value, the carrying amounts represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

(Thousands of Azerbaijani Manats)

21. Risk management (continued)

Credit risk (continued)

Credit-related commitments risks

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 8.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank internal credit ratings. The table below shows the credit quality by class of asset for loan-related lines in the consolidated statement of financial position, based on the Bank's credit rating system.

In the table below loans to banks and customers of high grade are those having a minimal level of credit risk, normally with a credit rating on or close to sovereign level or very well collateralized. Other borrowers with good financial position and good debt service are included in the standard grade. Sub-standard grade comprises loans below standard grade but not individually impaired.

		Neither past due nor impaired					
	Notes	High grade 2012	Standard grade 2012	Sub-standard grade 2012	Past due but not impaired 2012	Individually impaired 2012	Total 2012
Amounts due from credit institutions	7	3,942	8	-	-	-	**3,950**
Loans to customers	8						
Corporate lending		5,996	61,128	21,002	835	562	**89,523**
Consumer lending		-	11,263	33,807	2,234	320	**47,624**
Small business lending		-	10,440	423	180	-	**11,043**
Residential mortgages		-	2,031	47	-	-	**2,078**
Total gross loans to customers		**5,996**	**84,862**	**55,279**	**3,249**	**882**	**150,268**
Investment securities	9	6,075	-	-	-	-	**6,075**

		Neither past due nor impaired					
	Notes	High grade 2011 (as restated)	Standard grade 2011 (as restated)	Sub-standard grade 2011 (as restated)	Past due but not impaired 2011 (as restated)	Individually impaired 2011 (as restated)	Total 2011 (as restated)
Amounts due from credit institutions	7	2,965	12,388	-	-	-	**15,353**
Loans to customers	8						
Corporate lending		9,219	68,829	20,010	1,610	-	**99,668**
Consumer lending		-	2,130	14,942	726	-	**17,798**
Small business lending		-	7,632	480	54	-	**8,166**
Residential mortgages		-	596	80	43	-	**719**
Total gross loans to customers		**9,219**	**79,187**	**35,512**	**2,433**	-	**126,351**
Investment securities	9	8,312	-	-	-	-	**8,312**

An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The attributable risk ratings are assessed and updated regularly.

(Thousands of Azerbaijani Manats)

21. Risk management (continued)

Credit risk (continued)

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

	Less than 30 days 2012	*31 to 60 days 2012*	*61 to 90 days 2012*	*More than 90 days 2012*	*Total 2012*
Loans to customers					
Corporate lending	12	3	74	746	**835**
Consumer lending	764	245	170	1,055	**2,234**
Small business lending	5	-	-	175	**180**
Total	**781**	**248**	**244**	**1,976**	**3,249**

	Less than 30 days 2011 (as restated)	*31 to 60 days 2011 (as restated)*	*61 to 90 days 2011 (as restated)*	*More than 90 days 2011 (as restated)*	*Total 2011 (as restated)*
Loans to customers					
Corporate lending	413	761	-	436	**1,610**
Consumer lending	254	142	85	245	**726**
Small business lending	-	-	1	53	**54**
Residential mortgages	42	1	-	-	**43**
Total	**709**	**904**	**86**	**734**	**2,433**

See Note 8 for more detailed information with respect to the allowance for impairment of loans to customers.

Impairment assessment

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

Individually assessed allowances

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

Collectively assessed allowances

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

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

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

(Thousands of Azerbaijani Manats)

21. Risk management (continued)

Credit risk (continued)

Collectively assessed allowances (continued)

The geographical concentration of the Bank's monetary assets and liabilities is set out below:

	2012				*2011 (as restated)*			
	Azerbaijan	*OECD*	*CIS and other foreign banks*	*Total*	*Azerbaijan*	*OECD*	*CIS and other foreign banks*	*Total*
Assets:								
Cash and cash equivalents	28,468	15,450	231	**44,149**	31,651	49,182	49	**80,882**
Amounts due from credit institutions	3,950	-	-	**3,950**	15,353	-	-	**15,353**
Loans to customers	148,951	-	-	**148,951**	126,091	-	-	**126,091**
Investment securities	6,075	-	-	**6,075**	8,312	-	-	**8,312**
Other financial assets	320	-	-	**320**	1,339	-	-	**1,339**
	187,764	**15,450**	**231**	**203,445**	**182,746**	**49,182**	**49**	**231,977**
Liabilities:								
Amounts due to credit institutions	29,497	19,925	-	**49,422**	36,189	36,232	-	**72,421**
Amounts due to customers	104,845	-	-	**104,845**	104,341	-	-	**104,341**
Other financial liabilities	1,145	77	-	**1,222**	333	-	-	**333**
	135,487	**20,002**	**-**	**155,489**	**140,863**	**36,232**	**-**	**177,095**
Net assets / (liabilities)	**52,277**	**(4,552)**	**231**	**47,956**	**41,883**	**12,950**	**49**	**54,882**

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has developed a sophisticated system for comprehensive assessment of expected cash flows. The methodology of the liquidity management tools and reports is approved by the Supervisory Board of the Bank, prepared by the Assets and Liabilities Management department and reviewed on the monthly basis by Asset Liabilities Committee.

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. Additionally, the Bank maintains obligatory reserve with the CBA and utilizes a highly effective cash management system across all its branches, ATMs and balances of the correspondent accounts.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on minimum liquidity ratio of 30% established by the CBA. As at 31 December, these ratios were as follows:

	2012	*2011*
Instant Liquidity Ratio	66.83%	72.29%

(Thousands of Azerbaijani Manats)

21. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities

The tables below summarize the maturity profile of the Bank's financial liabilities at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

Financial liabilities As at 31 December 2012	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to credit institutions	29,541	20,229	-	-	**49,770**
Amounts due to customers	80,105	24,842	655	33	**105,635**
Other financial liabilities	1,222	-	-	-	**1,222**
Total undiscounted financial liabilities	**110,868**	**45,071**	**655**	**33**	**156,627**

Financial liabilities As at 31 December 2011	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Amounts due to credit institutions	36,370	36,363	-	-	**72,733**
Amounts due to customers	103,298	1,020	426	-	**104,744**
Other financial liabilities	333	-	-	-	**333**
Total undiscounted financial liabilities	**140,001**	**37,383**	**426**	-	**177,810**

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
2012	5,197	10,310	25,589	21,172	**62,268**
2011	108	5,058	17,946	5,475	**28,587**

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The Bank's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time.

The Bank does not receive any significant funds from any one organization or private individual. The maturity analysis does not exhibit any significant negative gaps in any given period.

Included in due to customers are term deposits of individuals. In accordance with the Azerbaijan legislation, the Bank is obliged to repay such deposits upon demand of a depositor. Refer to Note 15.

Market risk

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

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments.

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

(Thousands of Azerbaijani Manats)

21. Risk management (continued)

Market risk (continued)

Interest rate risk (continued)

The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2012 for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve. However, as interest rate of available–for–sale securities in the local market is based on the carried accrued discount or premiums on these securities at the time of purchase or sale (as included in actual price of purchased or sold securities), thus, any change in the rates to be applied to the fixed-rate available-for-sale financial assets does not have any impact or effect on equity.

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

Currency	*Increase in currency rate in % 2012*	*Effect on profit before tax 2012*	*Increase in currency rate in % 2011*	*Effect on profit before tax 2011*
USD	3.82	(250)	5.09	227
EUR	11.49	38	14.55	268

Currency	*Decrease in currency rate in % 2012*	*Effect on profit before tax 2012*	*Decrease in currency rate in % 2011*	*Effect on profit before tax 2011*
USD	(3.82)	250	(5.09)	(227)
EUR	(11.49)	(38)	(14.55)	(268)

Operational risk

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

22. Fair values of financial instruments

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

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

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

At 31 December 2012	*Level 1*	*Level 2*	*Level 3*	*Total*
Financial assets				
Investment securities – available-for-sale	6,015	-	60	**6,075**

(Thousands of Azerbaijani Manats)

22. Fair values of financial instruments (continued)

At 31 December 2011	*Level 1*	*Level 2*	*Level 3*	*Total*
Financial assets				
Investment securities – available-for-sale	8,252	-	60	**8,312**

At 31 December 2010	*Level 1*	*Level 2*	*Level 3*	*Total*
Financial assets				
Investment securities – available-for-sale	11,200	601	60	**11,861**

As of 31 December the Bank did not recognize gains or losses on level 3 financial instruments.

Investment securities available-for-sale

Investment securities available-for-sale valued using a valuation technique or pricing models primarily consist of unquoted equity and debt securities. These securities are valued using models which sometimes only incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

Fair value of financial assets and liabilities not carried at fair value

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the consolidated statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2012	*Fair value 2012*	*Unrecognised gain / (loss) 2012*
Financial assets			
Cash and cash equivalents	44,149	44,149	-
Amounts due from credit institutions	3,950	3,950	-
Loans to customers	148,951	149,050	(99)
Other financial assets	320	320	-
Financial liabilities			
Amounts due to credit institutions	49,422	49,422	-
Amounts due to customers	104,845	104,845	-
Other financial liabilities	1,222	1,222	-

	Carrying value 2011 (as restated)	*Fair value 2011 (as restated)*	*Unrecognised gain / (loss) 2011*
Financial assets			
Cash and cash equivalents	80,882	80,882	-
Amounts due from credit institutions	15,353	15,353	-
Loans to customers	126,091	126,091	-
Other financial assets	64	64	-
Financial liabilities			
Amounts due to credit institutions	72,421	72,421	-
Amounts due to customers	104,341	104,341	-
Other financial liabilities	333	333	-

(Thousands of Azerbaijani Manats)

22. Fair values of financial instruments (continued)

Fair value of financial assets and liabilities not carried at fair value (continued)

	Carrying value 2010 (as restated)	*Fair value 2010 (as restated)*	*Unrecognised gain / (loss) 2011*
Financial assets			
Cash and cash equivalents	101,131	101,131	-
Amounts due from credit institutions	18,786	18,786	-
Loans to customers	70,094	70,094	-
Other financial assets	42	42	-
Financial liabilities			
Amounts due to credit institutions	79,077	79,077	-
Amounts due to customers	74,422	74,422	-
Other financial liabilities	311	311	-

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the consolidated financial statements.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and savings accounts without a specific maturity.

Fixed and variable rate financial instruments

For quoted debt instruments the fair values are determined based on quoted market prices. The fair values of unquoted debt instruments are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

23. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 21 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2012			*2011 (as restated)*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	44,149	-	**44,149**	80,882	-	**80,882**
Amounts due from credit institutions	3,950	-	**3,950**	15,353	-	**15,353**
Loans to customers	65,111	83,840	**148,951**	27,922	98,169	**126,091**
Investment securities	1,100	4,975	**6,075**	2,239	6,073	**8,312**
Property and equipment	-	10,482	**10,482**	-	4,427	**4,427**
Intangible assets	-	3,144	**3,144**	-	1,102	**1,102**
Other assets	600	3,583	**4,183**	2,119	840	**2,959**
Total	**114,910**	**106,024**	**220,934**	**128,515**	**110,611**	**239,126**
Amounts due to credit institutions	49,422	-	**49,422**	72,421	-	**72,421**
Amounts due to customers	104,161	684	**104,845**	103,917	424	**104,341**
Current income tax liabilities	340	-	**340**	178	-	**178**
Deferred income tax liabilities	-	491	**491**	-	593	**593**
Other liabilities	3,182	-	**3,182**	1,265	-	**1,265**
Total	**157,105**	**1,175**	**158,280**	**177,781**	**1,017**	**178,798**
Net	**(42,195)**	**104,849**	**62,654**	**(49,266)**	**109,594**	**60,328**

(Thousands of Azerbaijani Manats)

24. Related party disclosures

In accordance with IAS 24 "Related Party Disclosures", parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

Yapı ve Kredi Bankası A.Ş., owned by Koç Finansal Hizmetler A.Ş. is ultimate parent of the Bank.

YKB and KFS directly and indirectly controls and has significant influence over a significant number of entities. The Bank enters into banking transactions with these entities including but not limited to lending, deposit taking, cash settlement and foreign exchange transactions.

The outstanding balances of related party transactions are as follows:

	2012		*2011*	
	Parent	*Entities under common control*	*Parent*	*Entities under common control*
Loans outstanding at 1 January, gross	-	1,376	-	-
Loans issued during the year	-	1,570	-	3,028
Loan repayments during the year	-	(2,748)	-	(1,652)
Other movements	-	10	-	-
Loans outstanding at 31 December, gross	-	208	-	1,376
Less: allowance for impairment at 31 December	-	(3)	-	(28)
Loans outstanding at 31 December, net	-	205	-	1,348
Deposits at 1 January	36,232	-	-	-
Deposits received during the year	-	-	36,179	-
Deposits repaid during the year	(36,110)	-	-	-
Other movements	(122)	-	53	-
Deposits at 31 December	-	-	36,232	-
Current accounts at 31 December	-	439	-	657

The income and expense arising from related party transactions are as follows:

	2012		*2011*	
	Parent	*Entities under common control*	*Parent*	*Entities under common control*
Interest income	70	133	221	-
Interest expense	(106)	-	(115)	(14)
Fee and commission income	-	13	-	13
Fee and commission expense	(28)	-	(25)	-
General and administrative expenses	(140)	(116)	(42)	(34)

Compensation of key management personnel of 6 members (2011: 5 members) was comprised of the following:

	2012	*2011*
Salaries and short term benefits	785	736
Other accrued employee costs	40	31
Total key management personnel compensation	**825**	**767**

(Thousands of Azerbaijani Manats)

25. Capital adequacy

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

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders or return capital to shareholders. No changes were made in the objectives, policies and processes from the previous years.

The CBA requires each bank or banking group to: (a) hold the minimum level of share capital AZN 10,000 (2011: AZN 10,000); (b) maintain a ratio of total regulatory capital to the risk-weighted assets (the 'total capital ratio') at or above the prescribed minimum of 12% (2011: 12%) and (c) maintain a ratio of tier 1 capital to the risk-weighted assets (the 'Tier 1 capital ratio') at or above the prescribed minimum of 6% (2011: 6%).

Management believes that the Bank was in compliance with the statutory capital adequacy ratio throughout 2012 and 2011.

As at 31 December 2012, the Bank's capital adequacy ratio based on the CBA requirements was as follows:

	2012	*2011 (as restated)*
Tier 1 capital	60,329	52,196
Tier 2 capital	5,099	10,459
Less: deductions from capital	(3,144)	(1,102)
Total regulatory capital	**62,284**	**61,553**
Risk-weighted assets	**229,138**	**186,113**
Tier 1 capital adequacy ratio	26.33%	28.05%
Total capital adequacy ratio	27.18%	33.07%