“Yapi Kredi Bank Azerbaijan” CJSC

Consolidated financial statements

Year ended 31 December 2014
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 2014, and the consolidated statements of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year 2014, 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 the 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 audit 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 of the audited entity, 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 Azerbaijan CJSC and its subsidiary as at 31 December 2014, and their financial performance and cash flows for the year 2014 in accordance with International Financial Reporting Standards.

Ernst & Young Holdings (CIS) B.V.

14 April 2015

Consolidated statement of financial position

As at 31 December 2014

(Thousands of Azerbaijani manats)

	Notes	2014	2013
Assets			
Cash and cash equivalents	6	54,412	59,308
Amounts due from credit institutions	7	4,513	11,023
Loans to customers	8	262,331	218,271
Investment securities available-for-sale	9	8,753	5,045
Property and equipment	10	13,335	12,547
Intangible assets	11	6,683	4,757
Other assets	13	1,895	2,779
Total assets		**351,922**	**313,730**
Liabilities			
Amounts due to credit institutions	14	69,513	93,098
Amounts due to customers	15	169,383	150,084
Debt securities issued	16	38,376	–
Current income tax liabilities		1,317	–
Deferred income tax liabilities	12	556	674
Other liabilities	13	4,858	3,849
Total liabilities		**284,003**	**247,705**
Equity	17		
Share capital		46,811	46,811
Retained earnings		21,108	19,214
Total equity		**67,919**	**66,025**
Total liabilities and equity		**351,922**	**313,730**

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

Altan Şentürk — Chief Executive Officer / General Director

Khalida Hasanova — Chief of Accounting Control Department

14 April 2015

The accompanying notes on pages 5 to 36 are an integral part of these consolidated financial statements.

Consolidated statement of profit or loss and other comprehensive income

For the year ended 31 December 2014

(Thousands of Azerbaijani manats)

	Notes	*2014*	*2013*
Interest income			
Loans to customers		34,356	25,360
Investment securities		267	192
Amounts due from credit institutions		102	307
		34,725	**25,859**
Interest expense			
Amounts due to customers		(6,310)	(3,051)
Amounts due to credit institutions		(3,743)	(2,789)
Debt securities issued		(761)	–
		(10,814)	**(5,840)**
Net interest income		**23,911**	**20,019**
Allowance for loan impairment	8	(3,975)	(1,906)
Net interest income after allowance for loan impairment		**19,936**	**18,113**
Net fee and commission income	19	7,824	7,170
Net gains from foreign currency			
- dealing		3,647	3,380
- translation differences		39	35
Other income		14	15
Non-interest income		**11,524**	**10,600**
Personnel expenses	20	(12,315)	(11,359)
General and administrative expenses	21	(10,218)	(9,310)
Depreciation and amortization	10, 11	(4,735)	(3,602)
(Other impairment and provisions) / reversal of other impairment and provisions		(471)	177
Non-interest expense		**(27,739)**	**(24,094)**
Profit before income tax expense		**3,721**	**4,619**
Income tax expense	12	(1,827)	(1,248)
Profit for the year		**1,894**	**3,371**
Other comprehensive income for the year		–	–
Total comprehensive income for the year		**1,894**	**3,371**

The accompanying notes on pages 5 to 36 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2014

(Thousands of Azerbaijani manats)

	Share capital	*Retained earnings*	*Total*
31 December 2012	**46,811**	**15,843**	**62,654**
Profit for the year	–	3,371	**3,371**
Total comprehensive income for the year	**–**	**3,371**	**3,371**
31 December 2013	**46,811**	**19,214**	**66,025**
Profit for the year	–	1,894	**1,894**
Total comprehensive income for the year	**–**	**1,894**	**1,894**
31 December 2014	**46,811**	**21,108**	**67,919**

The accompanying notes on pages 5 to 36 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2014

(Thousands of Azerbaijani manats)

	Notes	*2014*	*2013*
Cash flows from operating activities			
Interest received		35,694	25,181
Interest paid		(9,255)	(4,572)
Fees and commissions received		9,518	8,596
Fees and commissions paid	19	(1,488)	(1,298)
Realized gains less losses from dealing in foreign currencies		3,647	3,380
Other income received		14	15
Personnel expenses paid		(12,059)	(11,198)
Other operating expenses paid		(10,203)	(9,361)
Cash flows from operating activities before changes in operating assets and liabilities		**15,868**	**10,743**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		6,482	(7,045)
Loans to customers		(48,942)	(70,575)
Other assets		869	1,350
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		(24,524)	42,991
Amounts due to customers		18,523	44,656
Other liabilities		(620)	660
Net cash (used in)/from operating activities before income tax		**(32,344)**	**22,780**
Income tax paid		(628)	(1,405)
Net cash (used in)/from operating activities		**(32,972)**	**21,375**
Cash flows from investing activities			
Purchase of investment securities available-for-sale		(21,606)	–
Proceeds from sale and redemption of investment securities available-for-sale		17,864	1,029
Purchase of property and equipment		(3,223)	(4,680)
Purchase of intangible assets	11	(3,530)	(2,600)
Net cash used in investing activities		**(10,495)**	**(6,251)**
Cash flows from financing activities			
Proceeds from bonds issued		38,532	–
Net cash from financing activities		**38,532**	**–**
Effect of exchange rates changes on cash and cash equivalents		39	35
Net (decrease)/increase in cash and cash equivalents		**(4,896)**	**15,159**
Cash and cash equivalents, beginning		**59,308**	**44,149**
Cash and cash equivalents, ending	6	**54,412**	**59,308**

The accompanying notes on pages 5 to 36 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 "CBAR") 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 subject to other conditions. The Yapi Kredi Bank's registered address is 73G Jalil Mammadguluzadeh street Baku, AZ1078, 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 73G Jalil Mammadguluzadeh street Baku, AZ1078, 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 14 branches (2013: 13 branches), 1 customer services unit (2013: 1) and 1 exchange office (2013: 1) within the Republic of Azerbaijan. The Bank had 463 employees at 31 December 2014 (2013: 424).

As at 31 December 2014 and 2013 the following shareholders owned the outstanding shares of the Bank:

Shareholder	***%***
Yapı ve Kredi Bankası A.Ş.	99.8
YK Yatirim Menkul Degerler A.Ş.	0.1
YK Lease A.Ş.	0.1
Total	**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 2014, 18.20% of the shares of YKB are publicly traded (31 December 2013: 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") as issued by International Accounting Standards Board ("IASB").

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.

3. Summary of accounting policies

Changes in accounting policies

The Bank has adopted the following amended IFRS which are effective for annual periods beginning on or after 1 January 2014:

Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)
These amendments provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. This amendment is not relevant to the Bank, since the Bank does not qualify to be an investment entity under IFRS 10.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

IAS 32 Offsetting Financial Assets and Financial Liabilities − Amendments to IAS 32
These amendments clarify the meaning of “currently has a legally enforceable right to set-off” and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting. These amendments had no impact on the Bank’s financial position.

IFRIC Interpretation 21 Levies (IFRIC 21)
IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. This IFRIC had no impact on the Bank’s consolidated financial statements as it has applied the recognition principles under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* consistent with the requirements of IFRIC 21 in prior years.

Recoverable Amount Disclosures for Non-Financial Assets – Amendments to IAS 36
These amendments remove the unintended consequences of IFRS 13 *Fair Value Measurement* on the disclosures required under IAS 36 *Impairment of Assets*. In addition, these amendments require disclosure of the recoverable amounts for the assets or cash-generating units (CGUs) for which an impairment loss has been recognized or reversed during the period. These amendments had no impact on the Bank’s financial position or performance.

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.

Fair value measurement

The Bank measures financial instruments, such as available-for-sale securities and derivatives at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortized cost are disclosed in Note 23.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Bank. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a market participant’s ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Fair value measurement (continued)

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 − Quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- Level 2 − Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;
- Level 3 − Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognized in the consolidated financial statements on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

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. 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 recognized 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.

Financial assets at fair value through profit or loss

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

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the loans and receivables are derecognized or impaired, as well as through the amortization 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 in any of the three preceding categories. 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 to the consolidated statement of profit or loss. However, interest calculated using the effective interest method is recognized in profit or loss.

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.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets (continued)

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 CBAR, 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 profit or loss and other comprehensive income. The obligation to return them is recorded at fair value as a trading liability.

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, amounts due to customers and debt securities issued. After initial recognition, borrowings are subsequently measured at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the borrowings are derecognized as well as through the amortization process.

If the Bank purchases its own debt, it is removed from the consolidated statement of financial position and the difference between the carrying amount of the liability and the consideration paid is recognized in profit or loss.

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.

Measurement of financial instruments at initial recognition

When financial instruments are recognized initially, they are measured at fair value, adjusted, in the case of instruments not at fair value through profit or loss, for directly attributable fees and costs.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Measurement of financial instruments at initial recognition (continued)

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Bank determines that the fair value at initial recognition differs from the transaction price, then:

- if the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets, the Bank recognizes the difference between the fair value at initial recognition and the transaction price as a gain or loss;
- in all other cases, the initial measurement of the financial instrument is adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the Bank recognizes that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the 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. The right of set-off must not be contingent on a future event and must be legally enforceable in all of the following circumstances:

- the normal course of business;
- the event of default; and
- the event of insolvency or bankruptcy of the entity and all of the counterparties.

These conditions are not generally met in master netting agreements, and the related assets and liabilities are presented gross in the consolidated statement of financial position.

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 in profit or loss. 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 profit or loss and other 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

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

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.

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 profit or loss – is reclassified from other comprehensive income to the consolidated statement of profit or loss and other comprehensive income. Impairment losses on equity investments are not reversed through the consolidated statement of profit or loss and other comprehensive income; increases in their fair value after impairment are recognized in other comprehensive income.

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

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.

Derecognition of financial assets and liabilities

Financial assets

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 '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.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

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.

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 profit or loss and other 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 profit or loss and other comprehensive income. The premium received is recognized in profit or loss 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 general and administrative 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.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Property and equipment (continued)

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:

	Years
Leasehold improvements	4-15
Furniture and fixtures	4-5
Computers and office equipment	4
Motor vehicles	4

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 other than goodwill 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 cost 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.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

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:

- *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 profit or loss and other comprehensive income as gains less losses from foreign currencies – 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 CBAR 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 2014 and 2013 in the preparation of these consolidated financial statements:

	2014	***2013***
1 US dollar	AZN 0.7844	AZN 0.7845
1 EUR	AZN 0.9522	AZN 1.0780

Standards and interpretations issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's consolidated financial statements are disclosed below.

IFRS 9 Financial Instruments
In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before 1 February 2015. The adoption of IFRS 9 will have an effect on the classification and measurement of the Bank's financial assets, but no impact on the classification and measurement of the Bank's financial liabilities.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

IFRS 15 Revenue from Contracts with Customers
IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Revenue arising from lease contracts within the scope of IAS 17 *Leases*, insurance contracts within the scope of IFRS 4 *Insurance Contracts* and financial instruments and other contractual rights and obligations within the scope of *IAS 39 Financial Instruments: Recognition and Measurement* (or IFRS 9 *Financial Instruments,* if early adopted) is out of IFRS 15 scope and is dealt by respective standards.

Under IFRS 15 revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recognizing revenue.

The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2017 with early adoption permitted. The Bank is currently assessing the impact of IFRS 15 and plans to adopt the new standard on the required effective date.

Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortization
The amendments clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortize intangible assets. The amendments are effective prospectively for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact to the Bank given that the Bank has not used a revenue-based method to depreciate its non-current assets.

Annual improvements 2010-2012 Cycle

These improvements are effective from 1 July 2014 and are not expected to have a material impact on the Bank. They include:

IFRS 8 Operating Segments
The amendments are applied retrospectively and clarify that:

- An entity must disclose the judgments made by management in applying the aggregation criteria in paragraph 12 of IFRS 8, including a brief description of operating segments that have been aggregated and the economic characteristics (e.g., sales and gross margins) used to assess whether the segments are 'similar'
- The reconciliation of segment assets to total assets is only required to be disclosed if the reconciliation is reported to the chief operating decision maker, similar to the required disclosure for segment liabilities.

IFRS 13 Short-term Receivables and Payables – Amendments to IFRS 13
This amendment to IFRS 13 clarifies in the Basis for Conclusions that short-term receivables and payables with no stated interest rates can be measured at invoice amounts when the effect of discounting is immaterial.

IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets
The amendment is applied retrospectively and clarifies in IAS 16 and IAS 38 that the asset may be revalued by reference to observable data on either the gross or the net carrying amount. In addition, the accumulated depreciation or amortization is the difference between the gross and carrying amounts of the asset.

IAS 24 Related Party Disclosures
The amendment is applied retrospectively and clarifies that a management entity (an entity that provides key management personnel services) is a related party subject to the related party disclosures. In addition, an entity that uses a management entity is required to disclose the expenses incurred for management services.

Annual improvements 2011-2013 Cycle

These improvements are effective from 1 July 2014 and are not expected to have a material impact on the Bank. They include:

IFRS 13 Fair Value Measurement
The amendment is applied prospectively and clarifies that the portfolio exception in IFRS 13 can be applied not only to financial assets and financial liabilities, but also to other contracts within the scope of IFRS 9 (or IAS 39, as applicable).

Annual improvements 2012-2014 Cycle

These improvements are effective on or after 1 January 2016 and are not expected to have a material impact on the Bank. They include:

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

IFRS 7 Financial Instruments: Disclosures – servicing contracts
IFRS 7 requires an entity to provide disclosures for any continuing involvement in a transferred asset that is derecognized in its entirety. The Board was asked whether servicing contracts constitute continuing involvement for the purposes of applying these disclosure requirements. The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and arrangement against the guidance for continuing involvement in paragraphs IFRS 7.B30 and IFRS 7.42C in order to assess whether the disclosures are required. The amendment must be applied for annual periods beginning on or after 1 January 2016, with earlier application permitted. The amendment is to be applied such that the assessment of which servicing contracts constitute continuing involvement will need to be done retrospectively. However, the required disclosures would not need to be provided for any period beginning before the annual period in which the entity first applies the amendments.

4. Significant accounting judgments and estimates

In the process of applying the Bank's accounting policies, management has made the following judgments, apart from those involving estimates, which have the most significant effect on the amounts recognized in the financial statements:

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.

Determination of collateral value

Management monitors market value of collateral on a regular basis. Management uses its experienced judgment 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.

Useful lives of property and equipment and intangible assets

Management determines the estimated useful lives and related depreciation and amortization charges for its property, plant and equipment and intangible assets. This estimate is based on projected period over which the Bank expects to consume economic benefits from the asset. The useful lives are reviewed at least at each reporting date. Changes in any of the above conditions or estimates may result in adjustments to future depreciation rates.

Fair value of financial instruments

When the fair values of financial assets and financial liabilities recorded on the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques. These techniques are derived from observable market data where possible, but if this is not available, judgment is required to establish fair values. The judgments include considerations of liquidity risk, credit risk and volatility for longer–dated financial assets and liabilities. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

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. Judgment 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 judgment is pricing for similar types of transactions with unrelated parties and effective interest rate analysis.

(Thousands of Azerbaijani manats)

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.

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 2014 or 2013.

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

2014	*Retail banking*	*Corporate banking*	*Unallocated*	*Total*
Revenue				
Interest income	19,958	14,500	267	**34,725**
Fee and commission income	6,745	2,567	–	**9,312**
Non-interest income	2,127	1,545	28	**3,700**
Total revenue	**28,830**	**18,612**	**295**	**47,737**
Interest expense	(4,789)	(6,025)	–	**(10,814)**
Fee and commission expense	(1,271)	(217)	–	**(1,488)**
Impairment charge on interest bearing assets	(2,466)	(1,509)	–	**(3,975)**
Non-interest expense	(16,144)	(11,385)	(210)	**(27,739)**
Segment results	**4,160**	**(524)**	**85**	**3,721**
Income tax expense	(2,042)	257	(42)	**(1,827)**
Profit/(loss) for the year	**2,118**	**(267)**	**43**	**1,894**
Other segment information				
Capital expenditure	4,378	3,181	59	**7,618**

2013	*Retail banking*	*Corporate banking*	*Unallocated*	*Total*
Revenue				
Interest income	14,464	11,203	192	**25,859**
Fee and commission income	4,736	3,732	–	**8,468**
Non-interest income	1,919	1,511	–	**3,430**
Total revenue	**21,119**	**16,446**	**192**	**37,757**
Interest expense	(1,256)	(4,584)	–	**(5,840)**
Fee and commission expense	(279)	(1,019)	–	**(1,298)**
Impairment charge on interest bearing assets	(1,952)	46	–	**(1,906)**
Non-interest expense	(13,476)	(10,439)	(179)	**(24,094)**
Segment results	**4,156**	**450**	**13**	**4,619**
Income tax expense	(698)	(541)	(9)	**(1,248)**
Profit/(loss) for the year	**3,458**	**(91)**	**4**	**3,371**
Other segment information				
Capital expenditure	4,072	3,154	54	**7,280**

Geographic information

The Bank's revenues from third party customers for the years ended 31 December 2014 and 2013 are generated in the Republic of Azerbaijan.

(Thousands of Azerbaijani manats)

6. Cash and cash equivalents

Cash and cash equivalents comprise:

	2014	*2013*
Cash on hand	20,549	19,890
Current accounts with the CBAR	11,302	25,118
Current accounts with other credit institutions	22,561	14,300
Cash and cash equivalents	**54,412**	**59,308**

Current accounts with other credit institutions consist of non-interest bearing correspondent account balances with resident and non–resident banks in the amount of AZN 649 (2013: AZN 258) and AZN 21,912 (2013: AZN 14,042), respectively.

7. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2014	*2013*
Obligatory reserve with the CBAR	4,505	5,103
Blocked accounts	8	8
Short-term loans to banks	–	5,912
Amounts due from credit institutions	**4,513**	**11,023**

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

As of 31 December 2013, short-term loans to banks include two loans to resident banks denominated in USD, maturing on 7 February 2014 and 13 January 2014 respectively, with the annual effective interest rates of 5%-6.25%.

8. Loans to customers

Loans to customers comprise:

	2014	*2013*
Corporate lending	145,962	118,364
Consumer lending	88,886	82,937
Small business lending	23,521	16,017
Residential mortgages	11,133	4,149
Gross loans to customers	**269,502**	**221,467**
Less: allowance for impairment	(7,171)	(3,196)
Loans to customers	**262,331**	**218,271**

(Thousands of Azerbaijani manats)

8. Loans to customers (continued)

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	*Small business lending*	*Consumer lending*	*Residential mortgages*	*Total*
At 1 January 2014	**1,504**	**377**	**1,315**	**–**	**3,196**
Charge for the year	1,509	282	2,011	173	**3,975**
At 31 December 2014	**3,013**	**659**	**3,326**	**173**	**7,171**
Individual impairment	1,285	333	234	124	**1,976**
Collective impairment	1,728	326	3,092	49	**5,195**
	3,013	**659**	**3,326**	**173**	**7,171**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**2,968**	**853**	**441**	**186**	**4,448**

	Corporate lending	*Small business lending*	*Consumer lending*	*Residential mortgages*	*Total*
At 1 January 2013	**527**	**32**	**758**	**–**	**1,317**
Charge for the year	977	345	584	–	**1,906**
Amounts written off	–	–	(27)	–	**(27)**
At 31 December 2013	**1,504**	**377**	**1,315**	**–**	**3,196**
Individual impairment	956	296	–	–	**1,252**
Collective impairment	548	81	1,315	–	**1,944**
	1,504	**377**	**1,315**	**–**	**3,196**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**3,359**	**861**	–	**–**	**4,220**

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2014, comprised AZN 303 (2013: AZN 230).

In accordance with the CBAR 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.

(Thousands of Azerbaijani manats)

8. Loans to customers (continued)

Concentration of loans to customers

As of 31 December 2014, the Bank had a concentration of loans represented by AZN 59,559 or 22% of gross loan portfolio (2013: AZN 45,070 or 20%) due from the ten largest third party borrowers.

Loans have been extended to the following types of customers:

	2014	*2013*
Private companies	145,962	118,364
Individuals	123,540	103,103
Gross loans to customers	**269,502**	**221,467**

Loans are made within Azerbaijan in the following industry sectors:

	2014	*2013*
Individuals	123,540	103,103
Trading enterprises	90,879	65,764
Real estate construction	29,408	30,698
Manufacturing	25,675	21,902
Gross loans to customers	**269,502**	**221,467**

9. Investment securities available-for-sale

Investment securities available-for-sale comprise:

	2014	*2013*
Bonds issued by the Mortgage Fund of the Republic of Azerbaijan	8,693	3,148
Corporate unquoted shares (5% ownership interest at Baku Stock Exchange)	60	60
Treasury bills of the Ministry of Finance of the Republic of Azerbaijan	–	1,837
Available-for-sale securities	**8,753**	**5,045**

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

	2014		*2013*	
	Annual interest rate	*Maturity*	*Annual interest rate*	*Maturity*
Bonds issued by the Mortgage Fund of the Republic of Azerbaijan	3.00%	December 2023	3.25%	December 2019
Treasury bills of the Ministry of Finance of the Republic of Azerbaijan	–	–	5.0%	February 2014-April 2014

(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 2013	**9,557**	**8,247**	**1,773**	**127**	**19,704**
Additions	2,035	1,585	468	–	**4,088**
Disposals	(231)	(169)	–	(16)	**(416)**
31 December 2014	**11,361**	**9,663**	**2,241**	**111**	**23,376**
Accumulated depreciation					
31 December 2013	**(2,678)**	**(3,349)**	**(1,016)**	**(114)**	**(7,157)**
Depreciation charge	(1,100)	(1,647)	(383)	(1)	**(3,131)**
Disposals	231	–	–	16	**247**
31 December 2014	**(3,547)**	**(4,996)**	**(1,399)**	**(99)**	**(10,041)**
Net book value					
31 December 2013	**6,879**	**4,898**	**757**	**13**	**12,547**
31 December 2014	**7,814**	**4,667**	**842**	**12**	**13,335**

	Leasehold improvements	*Computers and office equipment*	*Furniture and fixtures*	*Motor vehicles*	*Total*
Cost					
31 December 2012	**8,126**	**5,878**	**984**	**134**	**15,122**
Additions	1,431	2,370	878	1	**4,680**
Disposals	–	(1)	(89)	(8)	**(98)**
31 December 2013	**9,557**	**8,247**	**1,773**	**127**	**19,704**
Accumulated depreciation					
31 December 2012	**(1,757)**	**(2,030)**	**(730)**	**(123)**	**(4,640)**
Depreciation charge	(921)	(1,319)	(373)	(2)	**(2,615)**
Disposals	–	–	87	11	**98**
31 December 2013	**(2,678)**	**(3,349)**	**(1,016)**	**(114)**	**(7,157)**
Net book value					
31 December 2012	**6,369**	**3,848**	**254**	**11**	**10,482**
31 December 2013	**6,879**	**4,898**	**757**	**13**	**12,547**

As at 31 December 2014 gross carrying amount of fully depreciated property and equipment is AZN 2,406 (2013: AZN 2,057).

11. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Total*
Cost			
31 December 2013	**3,600**	**3,412**	**7,012**
Additions	2,198	1,332	**3,530**
31 December 2014	**5,798**	**4,744**	**10,542**
Accumulated amortization			
31 December 2013	**(1,804)**	**(451)**	**(2,255)**
Amortization charge	(1,235)	(369)	**(1,604)**
31 December 2014	**(3,039)**	**(820)**	**(3,859)**
Net book value			
31 December 2013	**1,796**	**2,961**	**4,757**
31 December 2014	**2,759**	**3,924**	**6,683**

(Thousands of Azerbaijani manats)

11. Intangible assets (continued)

	Licenses	*Computer software*	*Total*
Cost			
31 December 2012	**2,571**	**1,841**	**4,412**
Additions	1,029	1,571	**2,600**
31 December 2013	**3,600**	**3,412**	**7,012**
Accumulated amortization			
31 December 2012	**(1,022)**	**(246)**	**(1,268)**
Amortization charge	(782)	(205)	**(987)**
31 December 2013	**(1,804)**	**(451)**	**(2,255)**
Net book value			
31 December 2012	**1,549**	**1,595**	**3,144**
31 December 2013	**1,796**	**2,961**	**4,757**

As at 31 December 2014 gross carrying amount of fully amortized intangible assets is AZN 1,276 (2013: AZN 746).

12. Taxation

The corporate income tax expense comprises:

	2014	*2013*
Current tax charge	(1,945)	(888)
Prior year tax expense actualization	–	(177)
Deferred tax credit/(charge) – reversal and origination of temporary differences	118	(183)
Income tax expense	**(1,827)**	**(1,248)**

Standard corporate income tax rate for companies (including banks) comprised 20% for 2014 and 2013.

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:

	2014	*2013*
Profit before income tax expense	**3,721**	**4,619**
Statutory tax rate	20%	20%
Theoretical income tax expense at the statutory rate	**(744)**	**(924)**
Tax effect of items which are not deductible or assessable for taxation purposes		
Non-deductible expenses	(1,093)	(314)
Other	10	(10)
Income tax expense	**(1,827)**	**(1,248)**

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

	2012	*Recognized in the statement of profit or loss and other comprehensive income*	*2013*	*Recognized in the statement of profit or loss and other comprehensive income*	*2014*
Tax effect of temporary differences					
Amounts due from credit institutions	–	–	–	(45)	(45)
Loans to customers	(770)	(344)	(1,114)	344	(770)
Property and equipment	(44)	319	275	(509)	(234)
Intangible assets	9	(112)	(103)	27	(76)
Other liabilities	320	(46)	274	295	569
Other assets	(6)	–	(6)	6	–
Deferred tax (liability)/asset	**(491)**	**(183)**	**(674)**	**118**	**(556)**

(Thousands of Azerbaijani manats)

13. Other assets and liabilities

Other assets comprise:

	2014	*2013*
Amounts in the course of settlement	432	1,123
Other financial assets	**432**	**1,123**
Prepayments	1,388	1,574
Other non-financial assets	75	82
Other non-financial assets	**1,463**	**1,656**
Other assets	**1,895**	**2,779**

As at 31 December 2014, prepayments of AZN 1,388 (2013: AZN 1,574) primarily comprise of advance payments for purchase of property and equipment, advertisement, insurance and rent services.

Other liabilities comprise:

	2014	*2013*
Payables on purchase of property and equipment	982	286
Settlements on plastic cards	389	1,375
Other financial liabilities	486	271
Other financial liabilities	**1,857**	**1,932**
Accrued employee costs	1,318	1,086
Deferred income	950	738
Provisions	494	23
Payables to social funds	89	68
Other non-financial liabilities	150	2
Other non-financial liabilities	**3,001**	**1,917**
Other liabilities	**4,858**	**3,849**

Accrued employee costs include bonuses for employees based on the financial performance of the Bank of AZN 665 (2013: AZN 515) and an accrual for unused vacations of AZN 653 (2013: AZN 571).

At 31 December 2014 and 2013, deferred income represents deferred revenue which was primarily comprised of fee received for issuance of plastic cards, guarantees and letter of credits.

14. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2014	*2013*
Loans from banks	64,475	36,107
Demand deposits	4,311	37,042
Amounts due to Azerbaijan Mortgage Fund	727	–
Time deposits	–	19,949
Amounts due to credit institutions	**69,513**	**93,098**

The Bank pays interest on demand deposits at the rates ranging from 3.00% p.a. to 3.50% p.a. for USD and from 0.25% p.a. to 2.50% p.a. for euro (2013: from 3.00% p.a. to 3.50% p.a. for USD, from 2.00% p.a. to 2.50% p.a. for euro).

As at 31 December 2014, the Bank had loans financed by the Azerbaijan Mortgage Fund amounting to AZN 727 maturing on July 2039, with the annual interest rates of 1-4% p.a.

During 2013, the Bank attracted deposits from one resident commercial bank and two non-resident commercial banks comprising AZN 19,949, maturing on 10 April 2014, with the annual interest rates of 1.51%-5.75% p.a.

(Thousands of Azerbaijani manats)

15. Amounts due to customers

The amounts due to customers include the following:

	2014	*2013*
Time deposits	89,290	79,239
Current accounts	80,093	70,845
Amounts due to customers	**169,383**	**150,084**
Held as security against guarantees	**56**	**531**

As at 31 December 2014, amounts due to customers of AZN 54,432 or 32% (2013: AZN 44,910 or 30%) 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 2014 comprised 7.09% (2013: 7.37%), while the average annual interest rate on term deposits of legal entities outstanding at 31 December 2014 was 7.53% (2013: 6.84%).

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

	2014	*2013*
Private enterprises	112,113	106,253
Individuals	56,496	42,360
Public organizations	774	1,471
Amounts due to customers	**169,383**	**150,084**

An analysis of customer accounts by economic sector follows:

	2014	*2013*
Trade	60,945	56,621
Individuals	56,496	42,360
Insurance	39,164	28,052
Real estate constructions	6,752	12,210
Transport and communication	5,252	9,370
Public organizations	774	1,471
Amounts due to customers	**169,383**	**150,084**

16. Debt securities issued

As at 31 December 2014 the balance of debt securities issued was AZN 38,376 (2013 – nil).

On 20 June 2014, the Bank issued domestic bonds having a nominal value of AZN 15,000 maturing on 20 June 2016. As at 31 December 2014, carrying amount of the placement comprised AZN 15,044.

On 18 December 2014, the Bank issued on private placement basis bonds having nominal value of USD 30,000 maturing on 19 December 2016. As at 31 December 2014, carrying amount of the placement comprised AZN 23,332.

17. Equity

As at 31 December 2014 and 2013 number of ordinary shares amounted to 2,340,535,194. All ordinary shares have a nominal value of 0.02 per share denominated in Azerbaijani manats and rank equally. Each share carries one vote.

The share capital of the Bank was contributed by the shareholders in Azerbaijani manats and they are entitled to dividends and any capital distribution in Azerbaijani manats.

(Thousands of Azerbaijani manats)

18. Commitments and contingencies

Operating environment

Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks as required by the market economy. 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.

Considering significant drop in crude oil prices during second half of 2014, there continues to be uncertainty regarding 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. In addition, as described in Note 27, Azerbaijani manat has been devalued against major currencies by approximately 34% on 21 February 2015.

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

Azerbaijani tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. Recent events within Azerbaijan suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review.

Management believes that as at 31 December 2014 its interpretation of the relevant legislation is appropriate and that the Bank's tax and social contribution position will be sustained.

Commitments and contingencies

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

	2014	*2013*
Credit related commitments		
Undrawn loan commitments	78,881	73,995
Guarantees issued	24,419	19,931
Letters of credit	1,439	2,116
	104,739	**96,042**
Operating lease commitments		
Not later than 1 year	2,053	1,928
Later than 1 year but not later than 5 years	8,407	8,567
Later than 5 years	2,439	2,664
	12,899	**13,159**
Commitments and contingencies (before deducting collateral)	**117,638**	**109,201**
Less – cash held as security against guarantees (Note 15)	(56)	(531)
Commitments and contingencies	**117,582**	**108,670**

Most of the outstanding guarantee letters as at 31 December 2014 and 2013 represent guarantees issued to clients for the latters' 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.

(Thousands of Azerbaijani manats)

19. Net fee and commission income

Net fee and commission income comprises:

	2014	*2013*
Plastic card operations	4,634	3,304
Cash operations	1,890	2,205
Settlements operations	1,675	1,685
Guarantees and letters of credit	621	641
Agent activities	390	586
Other	102	47
Fee and commission income	**9,312**	**8,468**
Plastic card operations	(1,079)	(898)
Settlements operations	(301)	(251)
Guarantees and letters of credit	(49)	(35)
Cash operations	(26)	(99)
Other	(33)	(15)
Fee and commission expense	**(1,488)**	**(1,298)**
Net fee and commission income	**7,824**	**7,170**

20. Personnel expenses

Personnel expenses comprise:

	2014	*2013*
Salaries and bonuses	(9,376)	(8,371)
Social security costs	(1,557)	(1,258)
Other employee benefits	(1,382)	(1,730)
Personnel expenses	**(12,315)**	**(11,359)**

21. General and administrative expenses

General and administrative expenses comprise:

	2014	*2013*
Occupancy and rent	(2,587)	(2,327)
Repairs and Maintenance	(1,533)	(1,367)
Marketing and advertising	(1,645)	(1,662)
Communications	(970)	(879)
Security	(959)	(837)
Support expenses	(450)	(240)
Legal and consultancy	(436)	(414)
Utilities	(292)	(202)
Entertainment	(189)	(171)
Office supplies	(169)	(245)
Operating taxes other than income tax	(168)	(83)
Business travel	(141)	(70)
Membership	(74)	(117)
Insurance	(56)	(56)
Fines, Penalties, and Forfeits	–	(116)
Other expenses	(549)	(524)
General and administrative expenses	**(10,218)**	**(9,310)**

(Thousands of Azerbaijani manats)

22. 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.

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.

(Thousands of Azerbaijani manats)

22. Risk management (continued)

Introduction (continued)

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.

Credit-related commitments risks

The Bank offers guarantees to its customers 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 risks similar to loans and these are mitigated by the same control processes and policies.

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

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 financial assets 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. Loans to customers and other financial assets with good financial position and good debt service are included in the standard grade. Sub-standard grade comprises loans below standard grade that had changes in the terms and conditions of loan agreements, but not individually impaired.

(Thousands of Azerbaijani manats)

22. Risk management (continued)

Credit risk (continued)

		Neither past due nor impaired					
2014	***Notes***	***High grade***	***Standard Grade***	***Sub-standard grade***	***Past due but not impaired***	***Individually impaired***	***Total***
Cash and cash equivalents (excluding cash on hand)	6	11,302	22,561	–	–	–	**33,863**
Amounts due from credit institutions	7	4,505	8	–	–	–	**4,513**
Loans to customers	8						
Corporate lending		–	125,820	15,034	2,140	2,968	**145,962**
Consumer lending		–	80,199	3,816	4,430	441	**88,886**
Small business lending		–	20,583	2,004	81	853	**23,521**
Residential mortgages		–	10,600	347	–	186	**11,133**
		–	**237,202**	**21,201**	**6,651**	**4,448**	**269,502**
Investment securities available-for-sale	9	8,753	–	–	–	–	**8,753**
Other financial assets	13	–	432	–	–	–	**432**
Total		**24,560**	**260,203**	**21,201**	**6,651**	**4,448**	**317,063**

		Neither past due nor impaired					
2013	***Notes***	***High grade***	***Standard Grade***	***Sub-standard grade***	***Past due but not impaired***	***Individually impaired***	***Total***
Cash and cash equivalents (excluding cash on hand)	6	25,118	14,300	–	–	–	**39,418**
Amounts due from credit institutions	7	5,103	5,920	–	–	–	**11,023**
Loans to customers	8						
Corporate lending		–	112,961	–	2,044	3,359	**118,364**
Consumer lending		–	79,655	1,668	1,614	–	**82,937**
Small business lending		–	15,094	42	20	861	**16,017**
Residential mortgages		–	4,147	–	2	–	**4,149**
		–	**211,857**	**1,710**	**3,680**	**4,220**	**221,467**
Investment securities available-for-sale	9	5,045	–	–	–	–	**5,045**
Other financial assets	13	–	1,123	–	–	–	**1,123**
Total		**35,266**	**233,200**	**1,710**	**3,680**	**4,220**	**278,076**

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.

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

2014	***Less than 30 days***	***31 to 60 Days***	***61 to 90 days***	***More than 90 days***	***Total***
Loans to customers					
Consumer lending	254	48	110	4,018	**4,430**
Corporate lending	295	1,045	575	225	**2,140**
Small business lending	–	–	37	44	**81**
Residential mortgages	–	–	–	–	**–**
Total	**549**	**1,093**	**722**	**4,287**	**6,651**

(Thousands of Azerbaijani manats)

22. Risk management (continued)

Credit risk (continued)

2013	*Less than 30 days*	*31 to 60 Days*	*61 to 90 Days*	*More than 90 days*	*Total*
Loans to customers					
Consumer lending	163	130	21	1,300	**1,614**
Corporate lending	1,542	–	–	502	**2,044**
Small business lending	–	–	–	20	**20**
Residential mortgages	2	–	–	–	**2**
Total	**1,707**	**130**	**21**	**1,822**	**3,680**

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)

22. Risk management (continued)

Credit risk (continued)

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

	2014				*2013*			
	Azerbaijan	***OECD***	***CIS and other foreign countries***	***Total***	***Azerbaijan***	***OECD***	***CIS and other foreign countries***	***Total***
Assets								
Cash and cash equivalents	32,500	21,537	375	**54,412**	45,266	12,672	1,370	**59,308**
Amounts due from credit institutions	4,513	–	–	**4,513**	11,023	–	–	**11,023**
Loans to customers	262,331	–	–	**262,331**	218,271	–	–	**218,271**
Investment securities	8,753	–	–	**8,753**	5,045	–	–	**5,045**
Other financial assets	432	–	–	**432**	1,123	–	–	**1,123**
	308,529	**21,537**	**375**	**330,441**	**280,728**	**12,672**	**1,370**	**294,770**
Liabilities								
Amounts due to credit institutions	5,038	64,475	–	**69,513**	40,049	53,049	–	**93,098**
Amounts due to customers	169,383	–	–	**169,383**	150,084	–	–	**150,084**
Debt securities issued	15,044	23,332	–	**38,376**	–	–	–	–
Other financial liabilities	1,857	–	–	**1,857**	1,932	–	–	**1,932**
	191,322	**87,807**	**–**	**279,129**	**192,065**	**53,049**	**–**	**245,114**
Net assets/(liabilities)	**117,207**	**(66,270)**	**375**	**51,312**	**88,663**	**(40,377)**	**1,370**	**49,656**

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 CBAR 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 CBAR. As at 31 December, these ratios were as follows:

	2014	***2013***
Instant Liquidity Ratio	61.92%	70.47%

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.

As at 31 December 2014	***Less than 3 months***	***3 to 12 months***	***1 to 5 years***	***Over 5 years***	***Total***
Financial liabilities					
Amounts due to credit institutions	9,188	25,698	37,110	843	**72,839**
Amounts due to customers	119,179	47,273	6,300	–	**172,752**
Debt securities issued	–	2,766	40,621	–	**43,387**
Other financial liabilities	1,857	–	–	–	**1,857**
Total undiscounted financial liabilities	**130,224**	**75,737**	**84,031**	**843**	**290,835**

(Thousands of Azerbaijani manats)

22. Risk management (continued)

Liquidity risk and funding management (continued)

As at 31 December 2013	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to credit institutions	41,137	15,931	40,309	–	**97,377**
Amounts due to customers	109,715	40,502	1,968	1	**152,186**
Other financial liabilities	1,932	–	–	–	**1,932**
Total undiscounted financial liabilities	**152,784**	**56,433**	**42,277**	**1**	**251,495**

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*
2014	86,818	12,924	4,997	-	**104,739**
2013	81,565	7,895	6,289	293	**96,042**

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 realize 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.

As at 31 December 2014 and 2013, the Bank did not have any instruments with floating interest rates.

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

Currency	*Increase in currency rate in % 2014*	*Effect on profit before tax 2014*	*Increase in currency rate in % 2013*	*Effect on profit before tax 2013*
USD	35.00	3,043	1.37	264
EUR	35.00	13	10.16	(27)

(Thousands of Azerbaijani manats)

22. Risk management (continued)

Market risk (continued)

Currency	*Decrease in currency rate in % 2014*	*Effect on profit before tax 2014*	*Decrease in currency rate in % 2013*	*Effect on profit before tax 2013*
USD	(8.74)	(760)	(1.37)	(264)
EUR	(10.70)	(4)	(10.16)	27

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.

23. Fair values of financial instruments

Fair value hierarchy

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
Investment securities available-for-sale	31 December 2014	8,693	–	60	**8,753**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2014	54,412	–	–	**54,412**
Amounts due from credit institutions	31 December 2014	–	–	4,513	**4,513**
Loans to customers	31 December 2014	–	–	262,331	**262,331**
Liabilities for which fair values are disclosed					
Amounts due to credit institutions	31 December 2014	–	–	69,513	**69,513**
Amounts due to customers	31 December 2014	–	–	169,383	**169,383**
Debt securities issued	31 December 2014	–	15,044	23,332	**38,376**

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
Investment securities available-for-sale	31 December 2013	3,148	1,837	60	**5,045**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2013	59,308	–	–	**59,308**
Amounts due from credit institutions	31 December 2013	–	–	11,023	**11,023**
Loans to customers	31 December 2013	–	–	218,271	**218,271**
Liabilities for which fair values are disclosed					
Amounts due to credit institutions	31 December 2013	–	–	93,098	**93,098**
Amounts due to customers	31 December 2013	–	–	150,084	**150,084**

(Thousands of Azerbaijani manats)

23. Fair values of financial instruments (continued)

Fair value hierarchy (continued)

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.

2014	***Carrying value***	***Fair value***	***Unrecognized gain/(loss)***
Financial assets			
Cash and cash equivalents	54,412	54,412	–
Amounts due from credit institutions	4,513	4,513	–
Loans to customers	262,331	264,233	1,902
Other financial assets	432	432	–
Financial liabilities			
Amounts due to credit institutions	69,513	69,513	–
Amounts due to customers	169,383	169,383	–
Debt securities issued	38,376	38,376	–
Other financial liabilities	1,857	1,857	–

2013	***Carrying value***	***Fair value***	***Unrecognized gain/(loss)***
Financial assets			
Cash and cash equivalents	59,308	59,308	–
Amounts due from credit institutions	11,023	11,023	–
Loans to customers	218,271	220,498	2,227
Other financial assets	1,123	1,123	–
Financial liabilities			
Amounts due to credit institutions	93,098	93,098	–
Amounts due to customers	150,084	150,084	–
Other financial liabilities	1,932	1,932	–

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.

Financial assets and financial liabilities carried at amortized cost

Fair value of the quoted notes is based on price quotations at the reporting date. The fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to credit institutions and other financial assets and liabilities is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities

(Thousands of Azerbaijani manats)

24. 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 22 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2014			*2013*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	54,412	–	**54,412**	59,308	–	**59,308**
Amounts due from credit institutions	4,513	–	**4,513**	11,023	–	**11,023**
Loans to customers	176,120	86,211	**262,331**	141,441	76,830	**218,271**
Investment securities available-for-sale	46	8,707	**8,753**	1,837	3,208	**5,045**
Property and equipment	–	13,335	**13,335**	–	12,547	**12,547**
Intangible assets	–	6,683	**6,683**	–	4,757	**4,757**
Other assets	1,760	135	**1,895**	2,271	508	**2,779**
Total	**236,851**	**115,071**	**351,922**	**215,880**	**97,850**	**313,730**
Amounts due to credit institutions	33,505	36,008	**69,513**	56,992	36,106	**93,098**
Amounts due to customers	163,567	5,816	**169,383**	148,466	1,618	**150,084**
Debt securities issued	101	38,275	**38,376**	–	–	**–**
Current income tax liabilities	1,317	–	**1,317**	–	–	**–**
Deferred income tax liabilities	–	556	**556**	–	674	**674**
Other liabilities	4,858	–	**4,858**	3,849	–	**3,849**
Total	**203,348**	**80,655**	**284,003**	**209,307**	**38,398**	**247,705**
Net	**33,503**	**34,416**	**67,919**	**6,573**	**59,452**	**66,025**

25. 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.

YKB and KFS directly and indirectly control and have 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.

(Thousands of Azerbaijani manats)

25. Related party disclosures (continued)

The outstanding balances of related party transactions are as follows:

	2014		2013	
	Parent	Entities under common control	Parent	Entities under common control
Loans outstanding at 1 January, gross	**–**	**–**	**–**	**208**
Loans issued during the year	–	–	–	2,050
Loan repayments during the year	–	–	–	(2,258)
Other movements	–	–	–	–
Loans outstanding at 31 December, gross	**–**	**–**	**–**	**–**
Less: allowance for impairment at 31 December	–	–	–	–
Loans outstanding at 31 December, net	**–**	**–**	**–**	**–**
Deposits at 1 January	**–**	**15,865**	**–**	**–**
Deposits received during the year	–	–	–	15,690
Deposits repaid during the year	–	(15,688)	–	–
Other movements		(177)		175
Deposits at 31 December	**–**	**–**	**–**	**15,865**
Current accounts at 31 December	**19,606**	**390**	**9,557**	**1,389**

	2014		2013	
	Parent	Entities under common control	Parent	Entities under common control
Loans borrowed at 1 January	**–**	**36,107**	**–**	**–**
Loans borrowed during the year	–	40,004	–	35,303
Loans repaid during the year	–	(20,394)	–	–
Other movements		184	–	804
Loans borrowed at 31 December	**–**	**55,901**	**–**	**36,107**

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

	2014		2013	
	Parent	Entities under common control	Parent	Entities under common control
Interest income	27	–	30	10
Interest expense		(1,904)		(979)
Fee and commission income	–	19	–	29
Fee and commission expense	(94)	(4)	(37)	–
General and administrative expenses	(161)	(319)	(167)	–

Compensation of key management personnel of 5 members (2013: 6 members) comprised the following:

	2014	2013
Salaries and short term benefits	1,049	999
Other accrued employee costs	32	42
Total key management personnel compensation	**1,081**	**1,041**

26. Capital adequacy

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

(Thousands of Azerbaijani manats)

26. Capital adequacy (continued)

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 CBAR requires each bank or banking group to: (a) hold the minimum level of share capital of AZN 10,000 (2013: 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% (2013: 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% (2013: 6%).

Management believes that the Bank was in compliance with the statutory capital adequacy ratio throughout 2014 and 2013.

As at 31 December 2014, the Bank's capital adequacy ratio based on the CBAR requirements was as follows:

	2014	***2013***
Tier 1 capital	66,025	62,654
Tier 2 capital	5,720	7,616
Less: deductions from capital	(6,683)	(4,757)
Total regulatory capital	**65,062**	**65,513**
Risk-weighted assets	**383,648**	**339,828**
Tier 1 capital adequacy ratio	15.47%	18.44%
Total capital adequacy ratio	16.96%	19.28%

27. Events after the reporting period

On 21 February 2015, the Azerbaijani manat has been devalued against the US dollar and other major currencies by approximately 34%. The exchange rates before and after devaluation were AZN 0.786 and AZN 1.050 to USD 1, respectively. This event could adversely affect the Bank's future results and financial position, including the quality of the loan portfolio. The Bank has taken precautionary measures it considered necessary in order to support the sustainability and development of the Bank's business in the foreseeable future.