“MUGANBANK” OPEN JOINT STOCK COMPANY

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

"MUGANBANK" OPEN JOINT STOCK COMPANY

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

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

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

In preparing the financial statements, management is responsible for:

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

Management is also responsible for:

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

The financial statements for the year ended December 31, 2011 were authorized for issue on April 4, 2012 by the Management Board of the Bank.

On behalf of the Management Board:

Elmir Hasanov
Chairman of the Management Board

April 4, 2012
Baku, the Republic of Azerbaijan

Galina Sidneva
Head of Finance Department

April 4, 2012
Baku, the Republic of Azerbaijan

INDEPENDENT AUDITORS' REPORT

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

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

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

April 4, 2012
Baku, the Republic of Azerbaijan

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

	Notes	Year ended December 31, 2011	Year ended December 31, 2010
Interest income	5,25	22,177	17,775
Interest expense	5,25	(11,160)	(10,306)
Net interest income before provision for impairment losses on interest bearing assets		**11,017**	**7,469**
Provision for impairment losses on interest bearing assets	6,25	(2,646)	(1,874)
Net interest income		**8,371**	**5,595**
Net gain on foreign exchange operations	7	157	92
Fee and commission income	8	9,954	5,766
Fee and commission expense	8	(814)	(708)
Provision for impairment losses on other operations	6	(254)	(33)
Other income		11	17
Net non-interest income		**9,054**	**5,134**
Operating income		**17,425**	**10,729**
Operating expenses	9,25	(11,246)	(8,323)
Profit before income tax		**6,179**	**2,406**
Income tax expense	10	(124)	(157)
Net profit for the year		**6,055**	**2,249**
Other comprehensive income/(loss)		86	(13)
Other comprehensive income/(loss) for the year		**86**	**(13)**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**6,141**	**2,236**
Earnings per share			
Basic and diluted *(AZN)*	11	55.61	22.79

On behalf of the Management Board:

Elmir Hasanov
Chairman of the Management Board

April 4, 2012
Baku, the Republic of Azerbaijan

Galina Sidneva
Head of Finance Department

April 4, 2012
Baku, the Republic of Azerbaijan

The notes on pages 9-59 form an integral part of these financial statements.

"MUGANBANK" OPEN JOINT STOCKCOMPANY

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

	Notes	December 31, 2011	December 31, 2010
ASSETS			
Cash and balances with the Central Bank of the Republic of Azerbaijan	12	37,735	31,131
Due from banks	13	5,190	15,107
Loans to customers	14,24	170,515	133,907
Available-for-sale investments	15	-	1,972
Property and equipment	16	24,260	22,775
Assets classified as held for sale	17	535	-
Other assets	18	1,152	669
TOTAL ASSETS		**239,387**	**205,561**
LIABILITIES AND EQUITY			
LIABILITIES:			
Due to banks and other financial institutions	19	102,004	88,253
Customer accounts	20,25	100,499	87,440
Debt securities issued	21	5,445	4,970
Deferred tax liability	10	378	360
Current income tax payable	10	93	-
Other liabilities	22	1,117	829
Total liabilities		**209,536**	**181,852**
EQUITY:			
Share capital	23	22,250	20,000
Revaluation reserve		822	736
Retained earnings		6,779	2,973
Total equity		**29,851**	**23,709**
TOTAL LIABILITIES AND EQUITY		**239,387**	**205,561**

On behalf of the Management Board:

Elmir Hasanov	**Galina Sidneva**
Chairman of the Management Board	**Head of Finance Department**
April 4, 2012	April 4, 2012
Baku, the Republic of Azerbaijan	Baku, the Republic of Azerbaijan

The notes on pages 9-59 form an integral part of these financial statements.

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

	Share capital	Revaluation reserve	Retained earnings	Total equity
December 31, 2009	**19,000**	**749**	**1,177**	**20,926**
Issue of ordinary shares	1,000	-	-	1,000
Total comprehensive (loss)/income for the year	-	(13)	2,249	2,236
Dividends declared and capitalized on ordinary shares	-	-	(453)	(453)
December 31, 2010	**20,000**	**736**	**2,973**	**23,709**
Issue of ordinary shares	2,250			2,250
Total comprehensive income for the year	-	86	6,055	6,141
Dividends declared and capitalized on ordinary shares	-	-	(2,249)	(2,249)
December 31, 2011	**22,250**	**822**	**6,779**	**29,851**

On behalf of the Management Board:

Elmir Hasanov
Chairman of the Management Board

April 4, 2012
Baku, the Republic of Azerbaijan

Galina Sidneva
Head of Finance Department

April 4, 2012
Baku, the Republic of Azerbaijan

The notes on pages 9-59 form an integral part of these financial statements.

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

	Notes	Year ended December 31, 2011	Year ended December 31, 2010
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income tax		6,179	2,406
Adjustments for non-cash items:			
Provision for impairment losses on interest bearing assets	6	2,646	1,874
Provision for impairment losses on other operations	6	254	33
Foreign exchange translation loss		60	57
Impairment of property and equipment	9	306	111
Depreciation and amortization	9	1,938	1,635
Change in interest accruals, net		(1,010)	568
Cash inflow from operating activities before changes in operating assets and liabilities		10,373	6,684
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposit with the Central Bank of the Republic of Azerbaijan		(1,645)	(6)
Due from banks		4,044	(3,792)
Loans to customers		(39,539)	(35,458)
Other assets		(400)	24
Increase in operating liabilities:			
Due to banks		13,846	27,618
Customer accounts		13,824	22,830
Other liabilities		34	90
Cash inflow from operating activities before taxation		537	17,990
Income tax paid		-	-
Net cash inflow from operating activities		**537**	**17,990**
CASH FLOWS FROM INVESTING ACTIVITIES:			
Payments for property, equipment and intangible assets		(3,735)	(1,174)
Proceeds from sale of available-for-sale investments		1,961	-
Payments for available-for-sale investments		-	(1,961)
Proceeds from sale of assets claasified as held for sale		-	54
Net cash outflow from investing activities		**(1,774)**	**(3,081)**

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

CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issue of ordinary shares	22	1	547
Proceeds from debt securities issued		381	3,315
Repayment of debt securities issued		-	(1,166)
Net cash inflow from financing activities		**382**	**2,696**
Effect of exchange rates change on cash and cash equivalents		(28)	(75)
NET INCREASE IN CASH AND CASH EQUIVALENTS		(883)	17,530
CASH AND CASH EQUIVALENTS, *at the beginning of the year*	12	39,953	22,423
CASH AND CASH EQUIVALENTS, *at the end of the year*	12	39,070	39,953

Interest paid and received by the Bank during the year ended December 31, 2011 amounted to AZN 11,521 thousand and AZN 24,425 thousand, respectively (2010: AZN 8,690 thousand and AZN 16,861 thousand, respectively).

On behalf of the Management Board:

Elmir Hasanov
Chairman of the Management Board

April 4, 2012
Baku, the Republic of Azerbaijan

Galina Sidneva
Head of Finance Department

April 4, 2012
Baku, the Republic of Azerbaijan

The notes on pages 9-59 form an integral part of these financial statements.

(In thousands of Azerbaijani Manats)

1. INTRODUCTION

“Muganbank” Open Joint Stock Company (the“Bank”) is a joint stock bank, which was incorporated in the Republic of Azerbaijan in 1992 as a closed joint stock company and later in 2005 it was registered as an open joint stock company. The Bank is regulated by the Central Bank of the Republic of Azerbaijan (the “CBRA”) and conducts its business under the general license for banking activities and foreign currency operations No: 29 issued on November 25, 1992 and renewed on November 10, 2000. The Bank had 30 and 2 divisions within the Republic of Azerbaijan as at December 31, 2011 (2010: 30 branches and 1 division). The Bank’s primary business consists of making payments and money transfers, commercial activities, trading with foreign currencies and originating loans and deposits and also guarantees.

Registered address and place of business:

The address of its registered office is 21 B, A. Rajabli Street, Baku, the Republic of Azerbaijan.

Shareholders of the Bank

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

Shareholder	December 31, 2011, %	December 31, 2010, %
Elmir Mehdiyev	63.50	63.50
Maqbet Mehdiyev	13.10	13.10
Vafa Valiyeva	12.05	12.05
Farida Mehdiyeva	11.35	11.35
Total	**100.00**	**100.00**

Operating Environment of the Bank

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

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

2. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

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

Going concern

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

Other basis of presentation criteria

These financial statements are presented in thousands of Azerbaijani Manats ("AZN"), unless otherwise indicated. These financial statements have been prepared under the historical cost convention, except measurement at a fair value of certain financial instruments and measurement of buildings at revalued amounts according to IFRS.

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

The principal accounting policies are set out below:

Recognition of interest income and expense

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

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

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

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

Recognition of fee and commission income and expense

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

Financial instruments

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

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

Financial assets

Financial assets are classified into the following specified categories: financial assets "at fair value through profit or loss" (FVTPL), "held-to-maturity" investments, "loans and receivables" and "available-for-sale" (AFS) financial assets. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Financial assets at FVTPL

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

Held-to-maturity investments

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

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

Loans and receivables

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

Gains and losses are recognized in profit and loss accounts when the loans and receivables are derecognized or impaired, as well as through the 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 profit and loss accounts. However, interest calculated using the effective interest method is recognized in profit and loss accounts.

Determination of fair value

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

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

Cash and cash equivalents

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

Due from banks

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

Loans to customers

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

Reclassification of financial assets

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

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

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

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

Impairment of financial assets

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

Assets carried at amortized cost

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

Such impairment losses are not reversed, unless if in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, such as recoveries, in which case the previously recognized impairment loss is reversed by adjustment of an allowance account.

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

Available-for-sale financial assets

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

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

Renegotiated loans

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

Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original or current effective interest rate.

Write off of loans and advances

Loans and advances are written off against the allowance for impairment losses when deemed uncollectible. Loans and advances are written off after management has exercized all possibilities available to collect amounts due to the Bank and after the Bank has sold all available collateral. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in profit and loss accounts in the period of recovery.

Derecognition of financial assets

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

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

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

Financial liabilities and equity instruments

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

Equity instruments

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

Financial liabilities

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

FVTPL

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

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

Other financial liabilities

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

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

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Due to banks and other financial institutions

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

Customer accounts

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

Debt securities issued

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

Financial guarantee contracts

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

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

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

Derecognition of financial liabilities

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

Offset of financial assets and liabilities

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

Leases

Financial leases are leases that transfer substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. The lease is classified as finance lease if:

- The lease transfers ownership of the asset to the lessee by the end of the lease term;
- The lease term is for the major part of the economic life of the asset even if title is not transferred;
- At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
- The leased assets are of a specialized nature such that only the lessee can use them without major modifications being made.

The Bank as leasee

Assets held under finance leases are initially recognized as assets of the Bank at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation.

Lease payments are apportioned between finance expenses and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance expenses are recognized immediately in profit and loss accounts unless they are directly attributable to qualifying assets, in which case they are capitalized in accordance with the Bank's general policy on borrowing costs. Contingent rentals are recognized as expenses in the periods in which they are incurred.

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

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

Property, equipment and intangible assets

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

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

Depreciation and amortization are charged on the carrying value of property, equipment and intangible assets and is designed to write off assets over their useful economic lives. The estimated useful lives, residual values and depreciation/amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following useful lives:

(In thousands of Azerbaijani Manats)

	2011	2010
Buildings	20 years	20 years
Furniture and fixtures	8 years	8 years
Computer and equipments	6 years	6 years
Vehicles	10 years	10 years
Other fixed assets	5 years	5 years
Intangible assets	10 years	10 years

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

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

Buildings are stated in the statement of financial position at their revalued amounts, being the fair value at the date of revaluation, determined from market-based evidence by appraisal undertaken by professional independent appraisers, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the reporting date.

The date of the latest appraisal was December 30, 2011. The next revaluation is preliminarily expected as at December 31, 2012.

Market value of property is assessed using the comparable sales method which involves analysis of market sales prices for similar real estate property.

Any revaluation increase arising on the revaluation of such buildings is credited to the property revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognized as an expense, in which case the increase is credited to the statement of comprehensive income to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of such buildings is charged as an expense to the extent that it exceeds the balance, if any, held in the properties revaluation reserve relating to a previous revaluation of that asset.

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

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, the term of the relevant lease.

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

At the end of each reporting period, the Bank reviews the carrying amounts of its property, equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Bank estimates the recoverable amount of the cash-generating unit to which the asset belongs.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit and loss accounts, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit and loss accounts, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

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

Assets classified as held for sale

The Bank classifies a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the non-current asset must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and its sale must be highly probable.

The sale qualifies as highly probable if the Bank's management is committed to a plan to sell the non-current asset and an active program to locate a buyer and complete the plan must have been initiated. Further, the non-current asset must have been actively marketed for a sale at price that is reasonable in relation to its current fair value and in addition the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification of the non-current asset as held for sale.

The Bank measures an asset classified as held for sale at the lower of its carrying amount and fair value less costs to sell. The Bank recognizes an impairment loss for any initial or subsequent write-down of the asset to fair value less costs to sell if events or changes in circumstance indicate that their carrying amount may be impaired. Any subsequent increase in an asset's fair value less costs to sell is recognized to the extent of the cumulative impairment loss that was previously recognized in relation to that specific asset.

Taxation

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

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

In October 28, 2008, a law on “Stimulation of increase of capitalization of banks, insurance and reinsurance companies” was adopted. According to the law, part of the profit of banks, insurance and reinsurance companies directed to increase of their share capital will not be subject to profit tax for three years beginning from January 1, 2009.

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

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the statement of comprehensive income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

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

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

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

Provisions

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

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

(In thousands of Azerbaijani Manats)

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

Retirement and other benefit obligations

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

Contingencies

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

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognized as a deduction from equity, net of any tax effects. Dividends on ordinary shares are recognized in equity as a reduction in the period in which they are declared.

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

Foreign currency translation

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

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

Rates of exchange

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

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

Operating Segments

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

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

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

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

Critical accounting judgements and key sources of estimation uncertainty

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

Allowance for impairment of loans

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

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

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

The carrying amount of the allowance for impairment of interest bearing assets was AZN 6,419 thousand and AZN 3,967 thousand as at December 31, 2011 and 2010, respectively.

Valuation of Financial Instruments

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

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

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

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

Useful lives of property, equipment and intangible assets

The Bank reviews the estimated useful lives of property, equipment and intangible assets at the end of each annual reporting period. During the financial year, the directors determined that the useful lives of certain items of property and equipment should be revised, due to long usage of these items. As a result of the review, the estimated useful lives of classes were changed accordingly since January 1, 2010.

Furniture and fixtures - from 5 to 8 years;
Computer and equipments - from 4 to 6 years;
Vehicles - from 5 to 10 years.

Buildings are carried at revalued amounts.

3. ADOPTION OF NEW AND REVISED STANDARDS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

4. STANDARDS AND INTERPRETATIONS ISSUED AND NOT YET ADOPTED

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

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

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

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

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

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

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

- IFRS 9 requires all recognized financial assets that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* to be subsequently measured at amortized cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair values at the end of subsequent accounting periods;
- The most significant effect of IFRS 9 regarding the classification and measurement of financial liabilities relates to the accounting for changes in fair value of a financial liability (designated as at fair value through profit or loss) attributable to changes in the credit risk of that liability. Specifically, under IFRS 9, for financial liabilities that are designated as at fair value through profit or loss, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is recognized in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit and loss accounts. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit and loss accounts. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at fair value through profit and loss accounts was recognized in profit and loss accounts. IFRS 9 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted.

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

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

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

(In thousands of Azerbaijani Manats)

IFRS 12 “Disclosure of Interests in Other Entities” – IFRS 12 Disclosure of Interests in Other Entities issued in May 2011 is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. IFRS 12 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. Currently the Bank evaluates possible effect of the adoption of IFRS 11 on its financial position and performance.

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

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

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

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

5. NET INTEREST INCOME

	Year ended December 31, 2011	Year ended December 31, 2010
Interest income comprises:		
Interest income on financial assets recorded at amortized cost:		
Interest income on impaired financial assets	10,519	12,838
Interest income on unimpaired assets	11,270	4,632
Interest income on guarantees	369	294
Other interest income	19	11
Total interest income	**22,177**	**17,775**
Interest income on financial assets recorded at amortized cost comprises:		
Interest income on loans to customers	21,225	16,897
Interest income on due from banks	564	573
Total interest income on financial assets recorded at amortized cost	21,789	17,470
Interest income on guarantees	369	294
Other interest income	19	11
Total interest income on other assets	388	305

(In thousands of Azerbaijani Manats)

Interest expense comprises:	Year ended December 31, 2011	Year ended December 31, 2010
Interest expense on financial liabilities recorded at amortized cost comprises:		
Interest expense on due to banks and other financial institutions	(3,482)	(2,520)
Interest expense on customer accounts	(7,572)	(7,516)
Interest expense on debt securities issued	(106)	(270)
Total interest expense	**(11,160)**	**(10,306)**
Net interest income before provision for impairment losses on interest bearing financial assets	**11,017**	**7,469**

6. ALLOWANCE FOR IMPAIRMENT LOSSES, OTHER PROVISIONS

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

	Loans to customers	Due from banks	Total
December 31, 2009	**2,293**	**-**	**2,293**
Provision	1,794	80	1,874
Write-off of loans	(214)	-	(214)
Recoveries of loans previously written off	14	-	14
December 31, 2010	**3,887**	**80**	**3,967**
Provision	2,696	(50)	2,646
Write-off of loans	(194)	-	(194)
December 31, 2011	**6,389**	**30**	**6,419**

The movements in allowances for impairment losses on other assets, guarantees and other commitments were as follows:

	Guarantees and other commitments
December 31, 2009	**252**
Provision	33
December 31, 2010	**285**
Provision	254
December 31, 2011	**539**

(In thousands of Azerbaijani Manats)

7. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprises:

	Year ended December 31, 2011	Year ended December 31, 2010
Dealing, net	217	149
Translation differences, net	(60)	(57)
Total net gain on foreign exchange operations	**157**	**92**

8. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	Year ended December 31, 2011	Year ended December 31, 2010
Fee and commission income:		
Cash operations	7,617	4,352
Foreign exchange operations	895	281
Settlements and account servicing operations	877	700
Documentary operations	292	232
Plastic card operations	243	189
Other	30	12
Total fee and commission income	**9,954**	**5,766**
Fee and commission expense:		
Documentary operations	(519)	(398)
Plastic card operations	(174)	(203)
Settlements and account servicing operations	(97)	(68)
Cash operations	(20)	(37)
Securities operations	(1)	(2)
Other	(3)	-
Total fee and commission expense	**(814)**	**(708)**

9. OPERATING EXPENSES

Operating expenses comprise:

	Year ended December 31, 2011	Year ended December 31, 2010
Staff costs	5,750	4,066
Depreciation and amortization	1,938	1,635
Rental of premises	543	460
Security expenses	461	371
Communication expenses	587	304

(In thousands of Azerbaijani Manats)

	Year ended December 31, 2011	Year ended December 31, 2010
Printing and office supplies	190	295
Advertising expenses	363	291
Taxes other than income tax	287	237
Professional fees	124	127
Repair and maintenance	165	124
Impairment of the buildings	306	111
Utilities	100	72
Business trip expenses	66	64
Insurance expenses	51	57
Software maintenance	33	25
Membership fees	14	14
Other expenses	268	70
Total operating expenses	**11,246**	**8,323**

10. INCOME TAXES

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

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

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at December 31, 2011 and 2010 relate mostly to different methods/timing of income and expense recognition as well as to temporary differences generated by taxation bases' differences for certain assets.

In October 2008, the Government of the Republic of Azerbaijan has announced the three year profit tax holiday for financial institutions (banks, insurance and reinsurance companies) for increasing their capitalization. The tax holiday has become effective from January 1, 2009 and is applied prospectively. As a result of this law, if the subject matter of the taxable temporary differences is realized within the period of these holidays no tax liabilities should be accrued, otherwise it should be accrued using the current profit tax rate.

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

(In thousands of Azerbaijani Manats)

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

	December 31, 2011	December 31, 2010
Taxable temporary differences:		
Property and equipment	(1,890)	(1,799)
Total taxable temporary differences	**(1,890)**	**(1,799)**
Net taxable temporary differences	(1,890)	(1,799)
Net deferred income tax liability at the statutory tax rate of 20%	378	360
Net deferred income tax liability	**378**	**360**

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

	Year ended December 31, 2011	Year ended December 31, 2010
Profit before income tax	**6,179**	**2,406**
Statutory tax rate	20%	20%
Theoretical tax at the statutory tax rate	1,236	481
Theoretical income tax to be capitalized	(1,211)	(438)
Tax effect of permanent differences	99	114
Income tax expense	**124**	**157**

	Year ended December 31, 2011	Year ended December 31, 2010
Current income tax expense	95	-
Increase in deferred tax liability recognized in profit and loss	29	157
Income tax expense	**124**	**157**

	December 31, 2011	December 31, 2010
Deferred tax liability		
Beginning of the period	360	203
Increase in the deferred income tax recognized in profit and loss accounts	29	157
Decrease in the deferred income tax recognized in other components of comprehensive income	(11)	-
End of the period	**378**	**360**

(In thousands of Azerbaijani Manats)

11. EARNINGS PER SHARE

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

	Year ended December 31, 2011	Year ended December 31, 2010
Profit:		
Net profit for the year	6,055	2,249
Earnings used in calculation of earnings per share	**6,055**	**2,249**
Weighted average number of ordinary shares for basic earnings per share	108,875	98,668
Earnings per share – basic and diluted (AZN)	**55.61**	**22.79**

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

Cash and balances with the CBRA comprise:

	December 31, 2011	December 31, 2010
Cash	13,448	8,807
Balances with the CBRA	24,287	22,324
Total cash and balances with the CBRA	**37,735**	**31,131**

The obligatory minimum reserve deposits with the CBRA included in the balances with the CBRA as at December 31, 2011 and 2010, include AZN 1,865 thousand and AZN 220 thousand, respectively, which represent the minimum reserve deposits required by the CBRA. The Bank is required to maintain the reserve balance at the CBRA at all times provided that average daily balance for 30 days period will be eventually higher than required mandatory reserve.

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

	December 31, 2011	December 31, 2010
Cash and balances with the CBRA	37,735	31,131
Due from banks in OECD countries (Note 29)	3,200	9,042
	40,935	40,173
Less minimum reserve deposit with the CBRA	(1,865)	(220)
Total cash and cash equivalents	**39,070**	**39,953**

(In thousands of Azerbaijani Manats)

13. DUE FROM BANKS

Due from banks comprises:

	December 31, 2011	December 31, 2010
Correspondent accounts with other banks	3,386	9,212
Loans to banks	1,512	5,615
Restricted deposits	322	360
Less allowance for impairment losses	(30)	(80)
Total due from banks	**5,190**	**15,107**

Included in due from banks is in the amount of AZN 12 thousand and AZN 19 thousand as at December 31, 2011 and 2010, respectively is accrued interest receivable.

As at December 31, 2011 and 2010, maximum credit risk exposure of due from banks amounted to AZN 5,190 thousand and AZN 15,107 thousand, respectively.

14. LOANS TO CUSTOMERS

Loans to customers comprise:

	December 31, 2011	December 31, 2010
Originated loans	176,904	137,794
Less allowance for impairment losses	(6,389)	(3,887)
Total loans to customers, net	**170,515**	**133,907**

Included in loans to customers is accrued interest in the amount of AZN 3,410 thousand and AZN 2,746 thousand as at December 31, 2011 and 2010, respectively.

Movements in allowance for impairment losses for the years ended December 31, 2011 and 2010 are disclosed in Note 6.

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

	December 31, 2011	December 31, 2010
Loans collateralized by pledge of real estate	128,888	101,799
Loans collateralized by pledge of vehicles	17,378	14,711
Loans collateralized by cash deposits	2,036	4,684
Loans collateralized by guarantees	2,788	4,431
Loans collateralized by pledge of inventories	2,353	897
Loans collateralized by securities	190	245
Loans collateralized by others	3,858	2,568
Unsecured loans	13,024	4,572
Total loans to customers	**170,515**	**133,907**

(In thousands of Azerbaijani Manats)

	December 31, 2011	December 31, 2010
Analysis by industry:		
Trade and service	51,696	37,204
Individuals	51,010	38,297
Agriculture	31,432	24,183
Manufacturing	21,704	22,109
Construction	14,479	11,877
Other	194	237
Total loans to customers	**170,515**	**133,907**

Loans to individuals comprise the following products:

	December 31, 2011	December 31, 2010
Mortgage loans	25,830	18,627
Consumer loans	11,940	11,221
Car loans	7,664	5,141
Plastic cards	2,781	2,113
Other	2,795	1,195
Total loans to individuals, net	**51,010**	**38,297**

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

	Corporate loans	Loans to individuals - mortgage loans	Loans to individuals - consumer loans	Loans to individuals - car loans	Loans to individuals - plastic cards	Loans to individuals - others	Total
Unsecured loans	5,354	-	6,288	2	1,708	1,039	14,391
Loans collateralized by:							
real estate	103,337	25,830	4,093	-	35	-	133,295
vehicles	9,674	-	147	7,952	12	1	17,786
guarantees	1,256	-	842	-	748	-	2,846
cash deposits	638	-	1,108	-	343	-	2,089
inventories	2,382	-	-	-	-	-	2,382
securities	190	-	-	-	-	-	190
others	1,823	-	9	1	-	2,092	3,925
Less: Provision for loan impairment	(5,149)	-	(547)	(291)	(65)	(337)	(6,389)
Total loans to customers, net	**119,505**	**25,830**	**11,940**	**7,664**	**2,781**	**2,795**	**170,515**

(In thousands of Azerbaijani Manats)

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

	Corporate loans	Loans to individuals - mortgage loans	Loans to individuals - consumer loans	Loans to individuals - car loans	Loans to individuals - plastic cards	Loans to individuals - others	Total
Unsecured loans	739	-	2,378	-	1,570	-	4,687
Loans collateralized by:							
real estate	79,930	18,627	6,519	-	20	-	105,096
vehicles	6,001	-	-	5,258	12	-	11,271
guarantees	3,647	-	554	-	324	-	4,525
cash deposits	2,947	-	1,682	-	212	-	4,841
inventories	899	-	-	-	-	-	899
securities	251	-	-	-	-	-	251
others	4,729	-	298	-	2	1,195	6,224
Less: Provision for loan impairment	(3,533)	-	(210)	(117)	(27)	-	(3,887)
Total loans to customers, net	**95,610**	**18,627**	**11,221**	**5,141**	**2,113**	**1,195**	**133,907**

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

	Corporate loans	Loans to individuals - mortgage loans	Loans to individuals - consumer loans	Loans to individuals - car loans	Loans to individuals - plastic cards	Loans to individuals - others	Total
Unsecured loans	1,358	-	-	-	688	-	**2,046**
Loans collateralized by:							
real estate	49,491	25,830	-	-	-	-	**75,321**
vehicles	4,760	-	-	1	-	-	**4,761**
cash deposits	143	-	-	-	-	-	**143**
guarantees	939	-	-	-	-	-	**939**
inventories	1,359	-	-	-	-	-	**1,359**
securities	190	-	-	-	-	-	**190**
others	719	-	-	-	-	729	**1,448**
Total current and not impaired loans	**58,959**	**25,830**	**-**	**1**	**688**	**729**	**86,207**
Loans individually determined to be impaired							
current	59,504	-	11,881	7,683	2,072	2,388	**83,528**
less than 30 days overdue	382	-	77	120	20	2	**601**
30 to 90 days overdue	881	-	183	37	16	1.00	**1,118**
90 to 180 days overdue	2,791	-	132	46	9	10	**2,988**
180 to 360 days overdue	1,106	-	167	45	16	1	**1,335**
over 360 days overdue	1,031	-	47	23	25	1	**1,127**

(In thousands of Azerbaijani Manats)

	Corporate loans	Loans to individuals - mortgage loans	Loans to individuals - consumer loans	Loans to individuals - car loans	Loans to individuals - plastic cards	Loans to individuals - others	Total
Total individually impaired loans	**65,695**	**-**	**12,487**	**7,954**	**2,158**	**2,403**	**90,697**
Gross carrying value of total loans to customers	**124,654**	**25,830**	**12,487**	**7,955**	**2,846**	**3,132**	**176,904**
Less provision for loan impairment	**(5,149)**	**-**	**(547)**	**(291)**	**(65)**	**(337)**	**(6,389)**
Total loans to customers, net	**119,505**	**25,830**	**11,940**	**7,664**	**2,781**	**2,795**	**170,515**

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

	Corporate loans	Loans to individuals - mortgage loans	Loans to individuals - consumer loans	Loans to individuals - car loans	Loans to individuals - plastic cards	Loans to individuals - others	Total
Unsecured loans	-	-	-	-	1,020	-	**1,020**
Loans collateralized by:							
real estate	25,724	18,627	522	-	-	-	**44,873**
vehicles	6,001	-	-	-	-	-	**6,001**
cash deposits	1,569	-	1,682	-	211	-	**3,462**
guarantees	1,351	-	-	-	-	-	**1,351**
inventories	798	-	-	-	-	-	**798**
others	1,162	-	23	-	2	1,195	**2,382**
Total current and not impaired loans	**36,605**	**18,627**	**2,227**	**-**	**1,233**	**1,195**	**59,887**
Loans individually determined to be impaired							
current	59,923	-	8,246	5,140	874	-	**74,183**
less than 30 days overdue	1,165	-	489	32	5	-	**1,691**
30 to 90 days overdue	343	-	144	17	-	-	**504**
90 to 180 days overdue	460	-	104	8	3	-	**575**
180 to 360 days overdue	367	-	173	14	3	-	**557**
over 360 days overdue	280	-	48	47	22	-	**397**
Total individually impaired loans	**62,538**	**-**	**9,204**	**5,258**	**907**	**-**	**77,907**

(In thousands of Azerbaijani Manats)

	Corporate loans	Loans to individuals - mortgage loans	Loans to individuals - consumer loans	Loans to individuals - car loans	Loans to individuals - plastic cards	Loans to individuals - others	Total
Gross carrying value of total loans to customers	**99,143**	**18,627**	**11,431**	**5,258**	**2,140**	**1,195**	**137,794**
Less provision for loan impairment	**(3,533)**	**-**	**(210)**	**(117)**	**(27)**	**-**	**(3,887)**
Total loans to customers	**95,610**	**18,627**	**11,221**	**5,141**	**2,113**	**1,195**	**133,907**

As at December 31, 2011 and 2010, the Bank had 8loans to customers totaling to AZN 24,587 thousand and 7 customers totaling to AZN 21,539 thousand, respectively, which individually exceeded 10% of the Bank's equity.

As at December 31, 2011 and 2010, the Bank issued in total AZN 10,000 thousand loan to four companies for 3 years with 4.5% interest rate based on the funds attracted from CBRA in the amount of AZN 10,000 thousand with 2.5% interest rate per annum for three years as well. As at December 31, 2011 the balance of these loans amounted to AZN 6,242 thousand (2010: AZN 10,000 thousand).

As at December 31, 2011 and 2010, maximum credit risk exposure of loans to customers amounted to AZN 170,515 thousand and AZN 133,907 thousand, respectively.

As at December 31, 2011 and 2010, loans to customers included loans in the amount of AZN 9,490 thousand and AZN 7,528 thousand, respectively, with original terms renegotiated. Otherwise these loans would be past due or impaired.

15. AVAILABLE-FOR-SALE INVESTMENTS

Available-for-sale investments comprise:

	Interest to nominal %	December 31, 2011	Interest to nominal %	December 31, 2010
Debt securities				
Debt securities of the Mortgage Fund under the CBRA	-	-	3.25%	1,972
Total available-for-sale investments	**-**	**-**	**-**	**1,972**

As at December 31, 2010 available-for-sale investments included debt securities of Mortgage Fund under the CBRA in the amount of AZN 1,972 thousand, which were purchased on September 20, 2010 with the maturity in 10 years. Those debt securities were sold back to the Mortgage Fund during 2011.

(In thousands of Azerbaijani Manats)

16. PROPERTY AND EQUIPMENT

	Buildings	Furniture and fixtures	Computer and equipments	Vehicles	Other fixed assets	Total
At revalued/initial cost						
December 31, 2009	**21,772**	**3,186**	**715**	**657**	**83**	**26,413**
Additions	4	549	331	122	36	1,042
Revaluation	(124)	-	-	-	-	(124)
Disposals	(2,374)	(70)	(100)	-	(8)	(2,552)
December 31, 2010	**19,278**	**3,665**	**946**	**779**	**111**	**24,779**
Additions	2,983	437	168	-	29	3,617
Revaluation	(231)	-	-	-	-	(231)
Disposals	(1,250)	-	-	-	(2)	(1,252)
December 31, 2011	**20,780**	**4,102**	**1,114**	**779**	**138**	**26,913**
Accumulated depreciation						
December 31, 2009	**(1,287)**	**(1,048)**	**(326)**	**(260)**	**(29)**	**(2,950)**
Charge for the year	(1,087)	(345)	(101)	(53)	(20)	(1,606)
Eliminated on disposals	2,374	70	100	-	8	2,552
December 31, 2010	**-**	**(1,323)**	**(327)**	**(313)**	**(41)**	**(2,004)**
Charge for the year	(1,249)	(416)	(151)	(59)	(25)	(1,900)
Eliminated on disposals	-	-	-	-	2	2
Eliminated on revaluation	1,249	-	-	-	-	1,249
December 31, 2011	**-**	**(1,739)**	**(478)**	**(372)**	**(64)**	**(2,653)**
Net book value						
December 31, 2011	**20,780**	**2,363**	**636**	**407**	**74**	**24,260**
December 31, 2010	**19,278**	**2,342**	**619**	**466**	**70**	**22,775**

As at December 31, 2011 and 2010, included in property and equipment were fully depreciated assets in the amount of AZN 124 and AZN 118 thousand, respectively.

As at December 31, 2011 the buildings owned by the Bank were carried at revalued amounts based on the independent appraiser's report. Carrying value of these building totaled to AZN 20,780 thousand.

(In thousands of Azerbaijani Manats)

17. NON-CURRENT ASSETS HELD FOR SALE

According to the state registration certificate of the Azerbaijan Republic the real estate collateralized for customer loans have been repossessed by the Bank, due to default of the borrower. The fair value of this real estate approximates to AZN 535 thousand. As at December 31, 2011, this property was classified as a held for sale. Management believes that these assets will be sold within one year period after the reporting date.

18. OTHER ASSETS

Other assets comprise:

	December 31, 2011	December 31, 2010
Other financial assets:		
Accrued interest receivable on gurantees issued	106	104
Settlements on plastic cards	153	78
Settlements on money transfers	190	52
Other receivables	1	69
Total other financial assets	**450**	**303**
Other non-financial assets:		
Intangible assets	347	266
Prepaid expenses	355	100
Total other assets	**1,152**	**669**

Intangible assets include software and licenses.

	Intangible assets
At cost	
December 31, 2009	**230**
Additions	132
December 31, 2010	**362**
Additions	119
December 31, 2011	**481**
Accumulated amortization	
December 31, 2009	**(67)**
Charge for the year	(29)
December 31, 2010	**(96)**
Charge for the year	(38)
December 31, 2011	**(134)**
Net book value	
December 31, 2011	**347**
December 31, 2010	**266**

(In thousands of Azerbaijani Manats)

19. DUE TO BANKS AND OTHER FINANCIAL INSITUTIONS

Due to banks and other financial institutions comprise:

	December 31, 2011	December 31, 2010
Loans from National Fund for Support of Entrepreneurship	26,859	26,411
Loans from EBRD and other financial institutions	27,110	21,107
Loans from Mortgage Fund under the CBRA	25,557	18,561
Loans from the CBRA	13,000	14,000
Deposits from Mortgage Fund under the CBRA	9,301	7,262
Loro accounts of other banks	177	912
Total due to banks and other financial institutions	**102,004**	**88,253**

Included in due to banks and other financial institutions in the amount of AZN 560 thousand and AZN 500 thousand as at December 31, 2011 and 2010, respectively is accrued interest payable.

The Bank is obligated to comply with financial covenants in relation to certain balances due to banks and other financial institutions disclosed above. These covenants include stipulated ratios, debt to equity ratios and various other financial performance ratios. The Bank has not breached any of these covenants during the years ended December 31, 2011 and 2010.

20. CUSTOMER ACCOUNTS

Customer accounts comprise:

	December 31, 2011	December 31, 2010
Deposits	74,013	60,841
Current and settlement accounts	26,486	26,599
Total customer accounts	**100,499**	**87,440**

Included in customer accounts in the amount of AZN 2,143 thousand and AZN 2,658 thousand as at December 31, 2011 and 2010, respectively is accrued interest payable.

Included in customer accounts in the amount of AZN 21,360 thousand and AZN 25,745 thousand as at December 31, 2011 and 2010, respectively are deposits blocked as collateral for loans issued.

As at December 31, 2011 and 2010, customer accounts in the amount of AZN 16,964 thousand (17%) and AZN 17,255 thousand (19.5%), respectively, were due to two customers, which represents significant concentration.

(In thousands of Azerbaijani Manats)

	December 31, 2011	December 31, 2010
Analysis by sector:		
Individuals	69,718	59,111
Construction	13,613	16,738
Trade	8,300	5,719
Insurance and leasing	7,914	3,780
Manufacturing	728	1,115
Agriculture	74	867
Transport and communications	13	30
Energy	3	4
Other	136	76
Total customer accounts	**100,499**	**87,440**

21. DEBT SECURITIES ISSUED

	December 31, 2011	December 31, 2010
Registered bonds in State Committee for Securities under the President of the Republic of Azerbaijan	5,445	4,970
Total debt securities issued	**5,445**	**4,970**

Debt securities issued represent bonds for the total amount of AZN 5,445 thousand as at December 31, 2011 (2010: AZN 4,970 thousand) issued by the Bank registered in the State Committee for Securities under the President of the Republic of Azerbaijan with the face value of AZN 50 each and on demand with annual fixed coupon rate equal to 2%. Bond holders have the right to demand repayment of principal any time. There are no restrictions regarding sale and purchase of the bonds in the secondary markets.

22. OTHER LIABILITIES

Other liabilities comprise:

	December 31, 2011	December 31, 2010
Other financial liabilities:		
Net payables under finance lease	61	220
Accrued expenses	103	99
Accounts of foreign currency traders	128	-
Settlements payable	219	40
Total other financial liabilities	**511**	**359**
Other non-financial liabilities:		
Provision for guarantees and other commitments (see Note 6)	539	285
Taxes, other than income tax payable	51	104
Deferred income on guarantees	-	80
Other	16	1
Total other liabilities	**1,117**	**829**

(In thousands of Azerbaijani Manats)

The future minimum lease payments under finance leases are as follows:

	December 31, 2011	December 31, 2010
Less than one year	65	211
Later than one year not later than five years	-	65
Total minimum lease payments	65	276
Less: deferred finance expenses	(4)	(56)
Net payables under finance lease	**61**	**220**
Current portion	61	159
Long-term portion	-	61
Net payables under finance lease	**61**	**220**

23. SHARE CAPITAL

As at December 31, 2011 and 2010, authorized, issued and paid-in share capital consisted of 111,250 and 100,000 ordinary shares with par value of AZN 200 each. All shares are ranked equally and carry one vote.

The below table provides a reconciliation of the number of ordinary shares outstanding as at December 31, 2011 and 2010:

	Ordinary shares
December 31, 2009	**95,000**
Issue of shares	5,000
December 31, 2010	**100,000**
Issue of shares	11,250
December 31, 2011	**111,250**

During 2011 year net profit of 2010 in the amount of AZN 2,249 thousand was capitalized as a share capital increase.

24. COMMITMENTS AND CONTINGENCIES

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

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

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

(In thousands of Azerbaijani Manats)

Provision for losses on contingent liabilities amounted to AZN 539 thousand and AZN 285 thousand as at December 31, 2011 and 2010, respectively.

As at December 31, 2011 and 2010 contingent liabilities comprise:

	December 31, 2011	December 31, 2010
Contingent liabilities and credit commitments		
Guarantees issued and similar commitments	26,985	18,617
Commitments on loans and unused credit lines	7,960	4,208
Total contingent liabilities and credit commitments	**34,945**	**22,825**

As at December 31, 2011 and 2010, included in commitments on loans and unused credit lines are AZN 7,959 thousand and AZN 4,208 thousand, respectively, representing the Bank's commitments to extend loans within unused credit line limits that are conditioned on the following: a borrower has to apply to the Bank each time it wants to extend its borrowings within preliminary unused portion and the Bank may approve the extension of finance based on a borrower's financial performance, debt service and other credit risk characteristics.

Capital commitments

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

Legal proceedings

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

Taxation

Commercial legislation and tax legislation of the Republic of Azerbaijan in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result, the Bank may be assessed additional taxes, penalties and interest. The Bank believes that it has already made all tax payments, and therefore no allowance has been made in the financial statements. Tax years remain open to review by the tax authorities for three years.

25. TRANSACTIONS WITH RELATED PARTIES

Related parties or transactions with related parties, as defined by IAS 24 "Related party disclosures", represent:

(a) Parties that directly, or indirectly through one or more intermediaries: control, or are controlled by, or are under common control with, the Bank (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Bank that gives then significant influence over the Bank and that have joint control over the Bank;

(b) Associates – enterprises on which the Bank has significant influence and which is neither a subsidiary nor a joint venture of the investor;

(In thousands of Azerbaijani Manats)

(c) Members of key management personnel of the Bank or its parent;

(d) Close members of the family of any individuals referred to in (a) or (c);

(e) Parties that are entities controlled, jointly controlled or significantly influenced by, or for which;

(f) Significant voting power in such entity resides with, directly or indirectly, any individual referred to in (c) or (d); or

(g) Post-employment benefit plans for the benefit of employees of the Bank, or of any entity that is a related party of the Bank.

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

	December 31, 2011		December 31, 2010	
	Related party balances	**Total category as per financial statements caption**	**Related party balances**	**Total category as per financial statements caption**
Loans to customers:				**133,907**
- shareholders of the Bank	1,161	**170,515**	1,153	
- key management personnel	2,200		1,948	
Allowance for impairment losses on loans to customers		**6,389**		**3,887**
- shareholders of the Bank	13		3	
- key management personnel	57		13	
Customer accounts		**100,499**		**87,440**
- shareholders of the Bank	5,137		124	
- key management personnel	3,102		2,445	

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

	Year ended December 31, 2011		Year ended December 31, 2010	
	Related party transactions	**Total category as per financial statements caption**	**Related party transactions**	**Total category as per financial statements caption**
Interest income		**22,177**		**17,775**
- shareholders of the Bank	175		140	
- key management personnel	262		215	
Interest expense		**11,160**		**10,306**
- shareholders of the Bank	122		15	
- key management personnel	316		299	
(Provision)/recovery of provision for impairment losses on interest bearing assets		**(2,646)**		**(1,874)**
- shareholders of the Bank	(16)		(1)	
- key management personnel	(5)		(6)	

(In thousands of Azerbaijani Manats)

	Year ended December 31, 2011		Year ended December 31, 2010	
	Related party transactions	**Total category as per financial statements caption**	**Related party transactions**	**Total category as per financial statements caption**
Key management personnel compensation:		**5,750**		**4,066**
- short-term employee benefits	474		359	

26. OPERATING SEGMENTS

Business segments

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

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

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies.Transactions between the operating segments consist only of reallocating of funds. Funds are ordinarily reallocated between segments, resulting in funding cost transfers disclosed in operating income. Interest charged for these funds are based on the Bank's cost of capital. There are no other material items of income or expense between the business segments. Internal charges and transfer pricing adjustments have been reflected in the performance of each business. Revenue sharing agreements are used to allocate external customer revenues to a business segment on a reasonable basis.

Segment information about these businesses is presented below:

	Retail Banking	**Corporate banking**	**Non-allocated**	**As at and for the year ended December 31, 2011**
Interest income	8,160	14,017	-	22,177
Interest expense	(6,999)	(4,161)	-	(11,160)
Provision for impairment losses on interest bearing assets	(1,036)	(1,610)	-	(2,646)
Net gain on foreign exchange operations	-	-	157	157
Fee and commission income	2,850	7,104	-	9,954
Fee and commission expense	-	(814)	-	(814)
Provision for impairment losses on other transactions	-	(254)	-	(254)
Other income	-	-	11	11
Operating income	2,975	14,282	168	17,425
Operating expenses	-	-	(11,246)	(11,246)
Profit/(loss) before income tax	2,975	14,282	(11,078)	6,179
Segment assets	50,460	164,320	24,607	239,387
Segment liabilities	69,718	138,230	1,588	209,536

(In thousands of Azerbaijani Manats)

	Retail Banking	Corporate banking	Non-allocated	As at and for the year ended December 31, 2011
Other segment items:				
Depreciation and amortization charge on property, equipment and intangible assets	-	-	1,938	1,938
Loans to customers	50,460	120,055	-	170,515
Property, equipment and intangible assets	-	-	24,607	24,607
Customer accounts	69,718	30,781	-	100,499

	Retail Banking	Corporate banking	Non-allocated	As at and for the year ended December 31, 2010
Interest income	10,998	6,777	-	17,775
Interest expense	(7,112)	(3,194)	-	(10,306)
Provision for impairment losses on interest bearing assets	(463)	(1,411)	-	(1,874)
Net gain on foreign exchange operations	-	-	92	92
Fee and commission income	2,851	2,915	-	5,766
Fee and commission expense	-	(708)	-	(708)
Provision for impairment losses on other transactions	-	(33)	-	(33)
Other income	-	-	17	17
Operating income	6,274	4,346	109	10,729
Operating expenses	-	-	(8,323)	(8,323)
Profit/(loss) before income tax	6,274	4,346	(8,214)	2,406
Segment assets	39,598	144,648	21,315	205,561
Segment liabilities	64,081	116,582	1,189	181,852
Other segment items				
Depreciation and amortization charge on property, equipment and intangible assets	-	-	1,635	1,635
Loans to customers	38,297	95,610	-	133,907
Property, equipment and intangible assets	-	-	23,041	23,041
Customer accounts	59,111	28,329	-	87,440

The Bank conducts its activities only within the Republic of Azerbaijan and major parts of its revenue and net profit arrives from operations in the Republic of Azerbaijan.

27. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale. The estimates presented herein are not necessarily indicative of the amounts the Bank could realize in a market exchange from the sale of its full holdings of a particular instrument.

(In thousands of Azerbaijani Manats)

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

	December 31, 2011		December 31, 2010	
	Carrying value	Fair value	Carrying value	Fair value
Cash and balances with the CBRA	37,735	37,735	31,131	31,131
Due from banks	5,190	5,190	15,107	15,107
Loans to customers	170,515	170,515	133,907	133,907
Available-for-sale investments	-	-	1,972	1,972
Other financial assets	450	450	303	303
Due to banks and other financial institutions	102,004	102,004	88,253	88,253
Customer accounts	100,499	100,499	87,440	87,440
Debt securities issued	5,445	5,445	4,970	4,970
Other financial liabilities	511	511	359	359

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

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

The Bank did not have financial instruments which would be disclosed under abovementioned hierarchy as at December 31, 2011.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy as at December 31, 2010:

At December 31, 2010	Level 1	Level 2	Level 3	Total
Financial assets				
Available-for-sale investments				
-Notes of Azerbaijan Mortgage Fund	-	1,972	-	1,972
	-	**1,972**	-	**1,972**

The methods and assumptions applied in determining fair values

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

(In thousands of Azerbaijani Manats)

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

28. REGULATORY MATTERS

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total (4%) and tier 1 capital (8%) to risk weighted assets. The ratio was calculated according to the principles employed by the Basle Committee by applying the following risk estimates to the assets and off-balance sheet commitments net of allowances for impairment losses:

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

As at December 31, 2011, the Bank’s total capital amount for Capital Adequacy purposes was AZN 32,545 thousand and tier 1 capital amount was AZN 29,028 thousand with ratios of 15.1% and 13.5%, respectively.

As at December 31, 2010, the Bank’s total capital amount for Capital Adequacy purposes was AZN 25,861 thousand and tier 1 capital amount was AZN 22,973 thousand with ratios of 15% and 13.3%, respectively.

29. CAPITAL MANAGEMENT

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

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

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

The Bank's overall capital risk management policy remains unchanged from previous period.

30. RISK MANAGEMENT POLICIES

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

- Credit exposures;
- Liquidity risk;
- Market risk.

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

Credit risk

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

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

Credit divisions

The Bank structures the level of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry (and geographical) segments. Limits on the level of credit risk by a borrower and a product (by industry sector, by region) are approved quarterly by the Management Board. The exposure to any one borrower including banks and brokers is further restricted by sub-limits covering on and off-balance sheet exposures which are set by the Credit Committee. Actual exposures against limits are monitored daily.Where appropriate, and in the case of most loans, the Bank obtains collateral and corporate and personal guarantees but a significant portion is personal lending, where no such facilities can be obtained. Such risks are monitored on a continuous basis and subject to annual or more frequent reviews.

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

(In thousands of Azerbaijani Manats)

Maximum Exposure of credit risk

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

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

	Maximum exposure	Offset	Net exposure after offset	Collateral pledged	December 31, 2011 Net exposure after offset and collateral
Due from banks	5,190	-	5,190	-	5,190
Loans to customers	170,515	2,036	168,479	155,455	13,024
Other financial assets	450	-	450	-	450
Guarantees issued and similar commitments	26,446	-	26,446	-	26,446
Unused loan commitments	7,960	-	7,960	-	7,960

	Maximum exposure	Offset	Net exposure after offset	Collateral pledged	December 31, 2010 Net exposure after offset and collateral
Due from banks	15,107	-	15,107	-	15,107
Loans to customers	133,907	4,684	129,223	124,651	4,572
Available-for-sale investments	1,972	-	1,972	-	1,972
Other financial assets	303	-	303	-	303
Guarantees issued and similar commitments	18,332	-	18,332	-	18,332
Unused loan commitments	4,208	-	4,208	-	4,208

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

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

	AAA	AA	A	BBB	<BBB	Not rated	RD	December 31, 2011 Total
Due from banks	-	104	2,942	158	33	1,874	79	5,190
Loans to customers	-	-	-	-	-	170,515	-	170,515
Other financial assets	-	-	-	-	-	450	-	450

(In thousands of Azerbaijani Manats)

	AAA	AA	A	BBB	<BBB	Not rated	RD	December 31, 2010 Total
Due from banks	-	-	9,044	25	869	5,105	64	15,107
Loans to customers	-	-	-	-	-	133,907	-	133,907
Available-for-sale investments	-	-	-	-	1,972	-	-	1,972
Other financial assets	-	-	-	-	-	303	-	303

The Bank has developed internal rating model, which allow it to determine the rating of counterparties. The rating of corporate borrower is based on an analysis of the financial ratios of the borrower, and an analysis of the market and industry sector, in which the borrower operates. The model also takes into consideration various qualitative factors, such as management efficiency and borrower's market share.

The application of the internal rating model results in a standardized approach in the analysis of corporate borrowers and provides a quantitative assessment of the creditworthiness of a borrower that does not have a rating from an international rating agency. The model takes into account specific local market conditions.

The quality of the internal rating model is examined on a regular basis through an assessment of both its effectiveness and validity. The Bank revises the model when deficiencies are identified.

The Bank applies internal rating methodologies to specific corporate loans and groups of retail and small business loans, which incorporate various underlying master scales that are different from that used by international rating agencies. As a result, it is not possible to make a cross-product score comparison which would agree to the outstanding balance of loans to customers per the statement of financial position. As such, more detailed information is not being presented.

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

Geographical concentration

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

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

	The Republic of Azerbaijan	Other non-OECD countries	OECD countries	December 31, 2011 Total
FINANCIAL ASSETS				
Cash and balances with the CBRA	37,735	-	-	37,735
Due from banks	1,615	329	3,246	5,190
Loans to customers	170,154	330	31	170,515
Available-for-sale investments	-	-	-	-
Other financial assets	266	184	-	450
TOTAL FINANCIAL ASSETS	**209,770**	**843**	**3,277**	**213,890**

(In thousands of Azerbaijani Manats)

	The Republic of Azerbaijan	Other non-OECD countries	OECD countries	December 31, 2011 Total
FINANCIAL LIABILITIES				
Due to banks and other financial institutions	90,130	-	11,874	102,004
Customer accounts	99,074	1,413	12	100,499
Debt securities issued	5,445	-	-	5,445
Other financial liabilities	511	-	-	511
TOTAL FINANCIAL LIABILITIES	**195,160**	**1,413**	**11,886**	**208,459**
NET POSITION	**14,610**	**(570)**	**(8,609)**	**5,431**

	The Republic of Azerbaijan	Other non-OECD countries	OECD countries	December 31, 2010 Total
FINANCIAL ASSETS				
Cash and balances with the CBRA	31,131	-	-	31,131
Due from banks	5,711	354	9,042	15,107
Loans to customers	133,642	265	-	133,907
Available-for-sale investments	1,972	-	-	1,972
Other financial assets	250	53	-	303
TOTAL FINANCIAL ASSETS	**172,706**	**672**	**9,042**	**182,420**
FINANCIAL LIABILITIES				
Due to banks and other financial institutions	79,353	-	8,900	88,253
Customer accounts	86,264	1,158	18	87,440
Debt securities issued	4,970	-	-	4,970
Other financial liabilities	353	5	1	359
TOTAL FINANCIAL LIABILITIES	**170,940**	**1,163**	**8,919**	**181,022**
NET POSITION	**1,766**	**(491)**	**123**	**1,398**

Liquidity risk

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

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

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

(In thousands of Azerbaijani Manats)

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

(i) The remaining contractual maturity of non-derivative financial liabilities based on the undiscounted cash flows of financial liabilities (both interest and principal cash flows) based on the earliest date on which the Bank can be required to pay; and
(ii) The expected maturity for non-derivative financial assets based on the undiscounted contractual maturities of the financial assets including interest that will be earned on those assets except where the Bank anticipates that the cash flow will occur in a different period.

An analysis of the liquidity and interest rate risks is presented in the following table. The presentation below is based upon the information provided internally to key management personnel of the entity.

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Overdue	December 31, 2011 Total
FINANCIAL ASSETS							
Due from banks	12	-	1,470	-	-	-	1,482
Loans to customers	7,668	9,959	51,215	72,454	23,413	5,806	170,515
Total interest bearing financial assets	**7,680**	**9,959**	**52,685**	**72,454**	**23,413**	**5,806**	**171,997**
Cash and balances with the CBRA	35,870	-	-	1,865	-	-	37,735
Due from banks	3,704	-	-	-	4	-	3,708
Other financial assets	450	-	-	-	-	-	450
Total financial assets	**47,704**	**9,959**	**52,685**	**74,319**	**23,417**	**5,806**	**213,890**
FINANCIAL LIABILITIES							
Due to banks and other financial institutions	12,558	3,307	24,152	39,021	22,789	-	101,827
Customer accounts	5,848	5,442	34,233	24,420	4,069	-	74,012
Debt securities issued	5,445	-	-	-	-	-	5,445
Other financial liabilities	12	19	30	-	-	-	61
Total interest bearing financial liabilities	**23,863**	**8,768**	**58,415**	**63,441**	**26,858**	**-**	**181,345**
Due to banks and other financial institutions	177	-	-	-	-	-	177
Customer accounts	26,487	-	-	-	-	-	26,487
Other financial liabilities	450	-	-	-	-	-	450
Total financial liabilities	**50,977**	**8,768**	**58,415**	**63,441**	**26,858**	**-**	**208,459**
Liquidity gap	(3,273)	1,191	(5,730)	10,878	(3,441)	**-**	**-**
Interest sensitivity gap	(16,183)	1,191	(5,730)	9,013	(3,445)	**-**	**-**
Cumulative interest sensitivity gap	**(16,183)**	**(14,992)**	**(20,722)**	**(11,709)**	**(15,154)**	**-**	**-**
Cumulative interest sensitivity gap as a percentage of total financial assets	**(8%)**	**(7%)**	**(10%)**	**(6%)**	**(7%)**	**-**	**-**

(In thousands of Azerbaijani Manats)

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Overdue	December 31, 2010 Total
FINANCIAL ASSETS							
Due from banks	-	4,737	798	-	-	-	5,535
Loans to customers	6,208	5,853	36,363	63,075	19,714	2,694	133,907
Available-for-sale investments	1,972	-	-	-	-	-	1,972
Total interest bearing financial assets	**8,180**	**10,590**	**37,161**	**63,075**	**19,714**	**2,694**	**141,414**
Cash and balances with the CBRA	30,911	-	-	220	-	-	31,131
Due from banks	9,570	-	-	-	2	-	9,572
Other financial assets	259	17	27	-	-	-	303
Total financial assets	**48,920**	**10,607**	**37,188**	**63,295**	**19,716**	**2,694**	**182,420**
FINANCIAL LIABILITIES							
Due to banks and other financial institutions	10,485	3,517	13,033	44,688	15,618	-	87,341
Customer accounts	2,958	5,114	42,138	8,555	-	-	58,765
Debt securities issued	4,970	-	-	-	-	-	4,970
Other financial liabilities	15	28	116	61	-	-	220
Total interest bearing financial liabilities	**18,428**	**8,659**	**55,287**	**53,304**	**15,618**	**-**	**151,296**
Due to banks and other financial institutions	912	-	-	-	-	-	912
Customer accounts	28,675	-	-	-	-	-	28,675
Other financial liabilities	72	27	40	-	-	-	139
Total financial liabilities	**48,087**	**8,686**	**55,327**	**53,304**	**15,618**	**-**	**181,022**
Liquidity gap	833	1,921	(18,139)	9,991	4,098	-	-
Interest sensitivity gap	(10,248)	1,931	(18,126)	9,771	4,096	-	-
Cumulative interest sensitivity gap	**(10,248)**	**(8,317)**	**(26,443)**	**(16,672)**	**(12,576)**	**-**	**-**
Cumulative interest sensitivity gap as a percentage of total financial assets	**(6%)**	**(5%)**	**(15%)**	**(9%)**	**(7%)**	**-**	**-**

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

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

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

(In thousands of Azerbaijani Manats)

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

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	December 31, 2011 Total
FINANCIAL LIABILITIES							
Due to banks and other financial institutions	3.34%	12,673	3,849	26,278	46,793	37,353	126,946
Customer accounts	10.27%	5,904	5,849	36,336	30,221	4,612	82,922
Debt securities issued	2%	5,445	-	-	-	-	5,445
Other financial liabilities	19%	13	20	32	-	-	65
Total interest bearing financial liabilities		**24,035**	**9,718**	**62,646**	**77,014**	**41,965**	**215,378**
Due to banks and other financial institutions		177	-	-	-	-	177
Customer accounts		26,487	-	-	-	-	26,487
Other financial liabilities		450	-	-	-	-	450
TOTAL FINANCIAL LIABILITIES		**51,149**	**9,718**	**62,646**	**77,014**	**41,965**	**242,492**

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

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	December 31, 2010 Total
FINANCIAL LIABILITIES							
Due to banks and other financial institutions	3.61%	10,459	3,940	15,088	50,182	25,372	105,041
Customer accounts	13.21%	3,008	5,111	47,572	9,542	-	65,233
Debt securities issued	2%	4,970	-	-	-	-	4,970
Other financial liabilities	19%	17	34	132	65	-	248
Total interest bearing financial liabilities		**18,454**	**9,085**	**62,792**	**59,789**	**25,372**	**175,492**
Due to banks and other financial institutions		912	-	-	-	-	912
Customer accounts		28,675	-	-	-	-	28,675
Other financial liabilities		72	27	40	-	-	139
TOTAL FINANCIAL LIABILITIES		**48,113**	**9,112**	**62,832**	**59,789**	**25,372**	**205,218**

(In thousands of Azerbaijani Manats)

Market risk

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

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

Interest rate risk

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

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

Impact on profit before tax:

	As at December 31, 2011		As at December 31, 2010	
	Interest rate +1%	Interest rate -1%	Interest rate +1%	Interest rate -1%
FINANCIAL ASSETS				
Due from banks	15	(15)	55	(55)
Loans to customers	1,705	(1,705)	1,339	(1,339)
Available-for-sale investments	-	-	20	(20)
FINANCIAL LIABILITIES				
Due to banks and other financial institutions	(1,018)	1,018	(873)	873
Customer accounts	(740)	740	(588)	588
Debt securities issued	(54)	54	(50)	50
Other financial liabilities	(1)	1	(2)	2
Net impact on profit before tax	**(93)**	**93**	**(99)**	**99**

Currency risk

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

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

(In thousands of Azerbaijani Manats)

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

	AZN	USD	EUR	Other	December 31, 2011 Total
FINANCIAL ASSETS					
Cash and balances with the CBRA	34,951	2,287	289	208	37,735
Due from banks	1,482	2,998	672	38	5,190
Loans to customers	133,184	35,369	1,962	-	170,515
Available-for-sale investments	-	-	-	-	-
Other financial assets	198	201	5	46	450
TOTAL FINANCIAL ASSETS	**169,815**	**40,855**	**2,928**	**292**	**213,890**
FINANCIAL LIABILITIES					
Due to banks and other financial institutions	86,423	15,030	551	-	102,004
Customer accounts	75,151	22,871	2,426	51	100,499
Debt securities issued	5,445	-	-	-	5,445
Other financial liabilities	335	171	5	-	511
TOTAL FINANCIAL LIABILITIES	**167,354**	**38,072**	**2,982**	**51**	**208,459**
OPEN CURRENCY POSITION	**2,461**	**2,783**	**-54**	**241**	**5,431**

	AZN	USD	EUR	Other	December 31, 2010 Total
FINANCIAL ASSETS					
Cash and balances with the CBRA	28,346	2,208	443	134	31,131
Due from banks	3,937	9,911	1,205	54	15,107
Loans to customers	102,497	28,723	2,687	-	133,907
Available-for-sale investments	1,972	-	-	-	1,972
Other financial assets	173	117	3	10	303
TOTAL FINANCIAL ASSETS	**136,925**	**40,959**	**4,338**	**198**	**182,420**
FINANCIAL LIABILITIES					
Due to banks and other financial institutions	74,446	12,215	1,592	-	88,253
Customer accounts	57,589	26,810	2,959	82	87,440
Debt securities issued	4,970	-	-	-	4,970
Other financial liabilities	298	56	4	1	359
TOTAL FINANCIAL LIABILITIES	**137,303**	**39,081**	**4,555**	**83**	**181,022**
OPEN CURRENCY POSITION	**(378)**	**1,878**	**(217)**	**115**	**1,398**

Currency risk sensitivity

The following table details the Bank's sensitivity to a 10% increase and decrease in the USD and EUR against AZN. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates.

(In thousands of Azerbaijani Manats)

The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Bank where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

	As at December 31, 2011		As at December 31, 2010	
	AZN/USD +10%	AZN/USD -10%	AZN/USD +10%	AZN/USD -10%
Impact on profit before tax	278	(278)	188	(188)

	As at December 31, 2011		As at December 31, 2010	
	AZN/EUR +10%	AZN/EUR -10%	AZN/EUR +10%	AZN/EUR -10%
Impact on profit before tax	5	(5)	(22)	22

Price risks

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

Limitations of sensitivity analysis

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

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

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

31. EVENTS AFTER THE REPORTING PERIOD

On March 12, 2012, the Bank authorized and issued 30,279 new ordinary shares with par value of AZN 200 each. All shares are ranked equally and carry one vote.