THE INTERNATIONAL BANK OF AZERBAIJAN

Consolidated Financial Statements
For the Year Ended December 31, 2011

THE INTERNATIONAL BANK OF AZERBAIJAN

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

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

In preparing the consolidated financial statements, management is responsible for:

- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's consolidated financial position and financial performance; and
- Making an assessment of the Group's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- Maintaining adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Preventing and detecting fraud and other irregularities.

The consolidated financial statements of the Group for the year ended December 31, 2011 were approved by management on June 29, 2012:

On behalf of the Board of Directors:

Mr. Jahangir Hajiyev	Mr. Rashad Gasimov
Chairman of the Board of Directors Baku, the Republic of Azerbaijan	Director of Accounting and Budgeting Department Baku, the Republic of Azerbaijan
June 29, 2012	June 29, 2012

Deloitte.

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors of the International Bank of Azerbaijan:

We have audited the accompanying consolidated financial statements of the International Bank of Azerbaijan and its subsidiaries (collectively – the "Group"), which comprise the consolidated statement of financial position as at December 31, 2011, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

Deloitte & Touche.

June 29, 2012
Baku, the Republic of Azerbaijan

THE INTERNATIONAL BANK OF AZERBAIJAN

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2011
(in thousands of Azerbaijan Manats)

	Note	December 31, 2011	December 31, 2010
ASSETS			
Cash and cash equivalents	5,30	391,381	677,830
Mandatory cash balances with the National/Central Banks	30	103,907	11,720
Due from other banks	6	101,665	131,362
Loans and advances to customers	7,30	4,008,184	3,303,431
Financial assets at fair value through profit or loss		5,857	1,278
Available-for-sale investments		4,051	-
Investment in associates	8	649	1,439
Premises, equipment and intangible assets	9	162,246	159,865
Current income tax asset	30	6,325	1,598
Deferred income tax asset	23	38,728	49,412
Other financial and insurance assets	10	4,674	6,586
Other assets	11	15,959	13,793
TOTAL ASSETS		4,843,626	4,358,314
LIABILITIES AND EQUITY			
LIABILITIES:			
Due to other banks	12,30	937,251	1,022,475
Customer accounts	13,30	2,757,280	2,111,615
Debt securities in issue	14	7,370	7,041
Other borrowed funds	15,30	755,870	825,657
Current income tax liability	30	963	424
Deferred income tax liability	23	2,145	1,816
Other financial and insurance liabilities	16	53,025	61,093
Other liabilities	17	7,067	9,848
Subordinated debt	18	50,139	66,834
TOTAL LIABILITIES		4,571,110	4,106,803
EQUITY:			
Equity attributable to owners of the Bank:			
Share capital	19	240,000	240,000
Cumulative translation reserve		(4,289)	(3,079)
Revaluation reserve for premises		21,074	19,939
Retained earnings/(accumulated deficit)		13,694	(6,479)
Total equity attributable to owners of the Bank		270,479	250,381
Non-controlling interest		2,037	1,130
Total equity		272,516	251,511
TOTAL LIABILITIES AND EQUITY		4,843,626	4,358,314

On behalf of the Board of Directors:

Mr. Jahangir Hajiyev

Chairman of the Board of Directors
Baku, the Republic of Azerbaijan

June 29, 2012

Mr. Rashad Gasimov

Director of Accounting and Budgeting Department
Baku, the Republic of Azerbaijan

June 29, 2012

The notes on pages 8-77 form an integral part of these consolidated financial statements

THE INTERNATIONAL BANK OF AZERBAIJAN

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 2011
(in thousands of Azerbaijan Manats)

	Note	Year ended December 31, 2011	Year ended December 31, 2010
Interest income	20,30	310,301	328,449
Interest expense	20,30	(193,996)	(168,757)
NET INTEREST INCOME		116,305	159,692
Initial recognition adjustment on interest bearing assets		(5,300)	(11,874)
Provision for impairment of due from other banks	6	(594)	(5,329)
Provision for impairment of loans to customers	7,30	(36,825)	(251,853)
NET INTEREST INCOME/(EXPENSE) AFTER PROVISION FOR IMPAIRMENT		73,586	(109,364)
Fee and commission income	21,30	81,059	80,753
Fee and commission expense	21	(22,470)	(15,642)
Fair value (loss)/gain on derivatives		(1,414)	502
Gains less losses from trading in foreign currencies		30,351	27,764
Foreign exchange translation gains less losses		(6,412)	(5,656)
Net loss on financial assets at fair value through profit or loss		(98)	(29)
Loss on revaluation of premises	9	(829)	-
Gross insurance premiums earned		11,261	8,774
Premiums ceded to reinsurers		(2,852)	(1,389)
Reversal of provision for insurance reserves, net of reinsurance	16	761	2,033
Net claims incurred		(5,689)	(5,197)
Other income	30	323	485
Administrative and other operating expenses	22,30	(122,154)	(116,022)
Share of loss of associates	8	(790)	(498)
PROFIT/(LOSS) BEFORE INCOME TAX		34,633	(133,486)
Income tax (expense)/benefit	23,30	(15,072)	22,881
PROFIT/(LOSS) FOR THE YEAR		19,561	(110,605)
OTHER COMPREHENSIVE INCOME/(LOSS):			
Cumulative translation reserve		(1,613)	(519)
Revaluation of premises	9	2,254	-
Income tax recorded directly in other comprehensive income	9	(447)	-
OTHER COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR		194	(519)
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR		19,755	(111,124)
PROFIT/(LOSS) IS ATTRIBUTABLE TO:			
Owners of the Bank		19,501	(110,301)
Non-controlling interest		60	(304)
PROFIT/(LOSS) FOR THE YEAR		19,561	(110,605)
TOTAL COMPREHENSIVE INCOME/(LOSS) IS ATTRIBUTABLE TO:			
Owners of the Bank		20,098	(110,690)
Non-controlling interest		(343)	(434)
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR		19,755	(111,124)
Earnings/(loss) per share for profit attributable to the owners of the Bank, basic and diluted (expressed in AZN per share)	24	0.02	(0.11)

On behalf of the Board of Directors:

Mr. Jahangir Hajiyev

Chairman of the Board of Directors
Baku, the Republic of Azerbaijan

June 29, 2012

Mr. Rashad Gasimov

Director of Accounting and Budgeting Department
Baku, the Republic of Azerbaijan

June 29, 2012

The notes on pages 8-77 form an integral part of these consolidated financial statements.

THE INTERNATIONAL BANK OF AZERBAIJAN

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2011
(in thousands of Azerbaijan Manats)

	Share capital	Cumulative translation reserve	Revaluation reserve for premises	Retained earnings/ (accumulated deficit)	Total equity attributable to owners of the Bank	Non-controlling interest	Total equity
December 31, 2009	240,000	(2,690)	21,876	101,885	361,071	1,564	362,635
Other comprehensive loss for the year	-	(389)	-	-	(389)	(130)	(519)
Loss for the year	-	-	-	(110,301)	(110,301)	(304)	(110,605)
Transfer to accumulated deficit	-	-	(1,937)	1,937	-	-	-
December 31, 2010	240,000	(3,079)	19,939	(6,479)	250,381	1,130	251,511
Other comprehensive income /(loss) for the year	-	(1,210)	1,807	-	597	(403)	194
Profit for the year	-	-	-	19,501	19,501	60	19,561
Transfer to accumulated deficit	-	-	(672)	672	-	-	-
Share capital increase in subsidiary	-	-	-	-	-	1,250	1,250
December 31, 2011	240,000	(4,289)	21,074	13,694	270,479	2,037	272,516

On behalf of the Board of Directors:

Mr. Jahangir Hajiyev

Chairman of the Board of Directors
Baku, the Republic of Azerbaijan

June 29, 2012

Mr. Rashad Gasimov

Director of Accounting and Budgeting Department
Baku, the Republic of Azerbaijan

June 29, 2012

The notes on pages 8-77 form an integral part of these consolidated financial statements.

THE INTERNATIONAL BANK OF AZERBAIJAN

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2011
(in thousands of Azerbaijan Manats)

	Note	Year ended December 31, 2011	Year ended December 31, 2010
CASH FLOWS FROM OPERATING ACTIVITIES:			
Interest received		254,156	287,697
Interest paid		(167,944)	(147,698)
Fees and commissions received		76,301	82,274
Fees and commissions paid		(20,947)	(14,220)
Insurance premiums received		12,605	10,221
Reinsurance premiums paid		(4,223)	(1,716)
Insurance claims paid		(5,689)	(5,197)
Income received from trading in foreign currencies		29,023	27,669
Other operating income received		353	1,338
Staff costs paid		(44,930)	(41,531)
Administrative and other operating expenses paid		(56,040)	(63,326)
Cash flows from operating activities before changes in operating assets and liabilities		72,665	135,511
Changes in operating assets and liabilities:			
Net increase in mandatory cash balances with the National/Central Banks		(92,187)	(2,584)
Cash collected on behalf of a related party		528,907	100,844
Cash paid on behalf of a related party		(528,907)	(100,844)
Net decrease in due from other banks		27,662	18,713
Net increase in loans and advances to customers		(705,047)	(428,974)
Net increase in financial assets at fair value through profit or loss		(4,681)	(1,307)
Net decrease in other financial and insurance assets		902	3,905
Net increase in other assets		(1,544)	(881)
Net decrease in due to other banks		(96,282)	(128,178)
Net increase in customer accounts		637,036	311,286
Net decrease in other financial and insurance liabilities		(10,113)	(70,543)
Net (decrease)/increase in other liabilities		(1,286)	949
Cash used by operating activities before taxation		(172,875)	(162,103)
Income tax paid		(9,141)	(27,311)
Net cash used in operating activities		(182,016)	(189,414)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Payment for premises, equipment and intangible assets		(15,261)	(23,587)
Payment for available-for-sale investments		(4,034)	-
Net cash used in investing activities		(19,295)	(23,587)

THE INTERNATIONAL BANK OF AZERBAIJAN

CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED DECEMBER 31, 2011
(in thousands of Azerbaijan Manats)

	Note	Year ended December 31, 2011	Year ended December 31, 2010
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net change in debt securities in issue		330	(791)
Proceeds from other borrowed funds		715,348	774,707
Repayment of other borrowed funds		(785,093)	(199,590)
Repayment of subordinated debt		(16,711)	-
Issue of subsidiary's ordinary share capital to non-controlling interest		1,250	-
Net cash (used in)/generated by financing activities		(84,876)	574,326
Effect of exchange rate changes on cash and cash equivalents		(262)	(638)
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		(286,449)	360,687
CASH AND CASH EQUIVALENTS, beginning of year	5	677,830	317,143
CASH AND CASH EQUIVALENTS, end of year	5	391,381	677,830

On behalf of the Board of Directors:

Mr. Jahangir Hajiyev
Chairman of the Board of Directors
Baku, the Republic of Azerbaijan

June 29, 2012

Mr. Rashad Gasimov
Director of Accounting and Budgeting Department
Baku, the Republic of Azerbaijan

June 29, 2012

The notes on pages 8-77 form an integral part of these consolidated financial statements.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

1. ORGANIZATION

The International Bank of Azerbaijan (the "Bank") was incorporated in 1991 as a fully state-owned bank and is domiciled in the Republic of Azerbaijan. On October 28, 1992, the Bank became a joint-stock commercial bank and the Ministry of Finance of the Republic of Azerbaijan ("MoF") became the major shareholder of the Bank. As at December 31, 2011 the MoF held 50.20% (December 31, 2010: 50.20%) of the total paid-in share capital of the Bank. The Bank is regulated by the Central Bank of the Republic of Azerbaijan (the "CBAR") and conducts its business under general full banking license issued on December 30, 1992. On March 1, 2005, a Presidential Decree, which outlined the process for privatisation of the state shareholding in the Bank's share capital, was enacted. The Bank's primary business consists of commercial activities, trading with securities, foreign currencies and derivative instruments, originating loans and guarantees.

The registered office of the Bank is located at 67, Nizami Street, AZ1005, Baku, the Republic of Azerbaijan.

As at December 31, 2011 and 2010 the Bank had 37 branches operating in the Republic of Azerbaijan, 5 representative offices in London, Frankfurt, Dubai, Luxemburg and New-York.

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

		Proportion of ownership interest/voting rights (%)		
Name	**Country of operation**	**2011**	**2010**	**Type of operation**
The International Bank of Azerbaijan	The Republic of Azerbaijan	Parent		Banking
Subsidiaries:				
IBA Moscow	Russian Federation	100.0	100.0	Banking
International Insurance Company	The Republic of Azerbaijan	100.0	100.0	Insurance
Azericard Limited	The Republic of Azerbaijan	100.0	100.0	Plastic cards
IBA Georgia	The Republic of Georgia	75.0	75.0	Banking
Associates:				
Joint Leasing	The Republic of Azerbaijan	47.6	47.6	Leasing
Baku Inter-Bank Currency Exchange	The Republic of Azerbaijan	20.0	20.0	Currency exchange

The ultimate controlling party of the Group is the Government of the Republic of Azerbaijan.

On January 24, 2002, the Group registered its fully-owned subsidiary, the International Bank of Azerbaijan - Moscow, in Moscow, the Russian Federation ("IBA Moscow"). The share capital of IBA Moscow was established in the amount of EUR 10,000,000. IBA Moscow operates under a licence issued by the Central Bank of the Russian Federation (the "CBRF") on January 25, 2002. This licence allows IBA Moscow to carry out banking operations with legal entities in Russian Roubles and in foreign currencies. During the first two years after its registration due to Russian statutory requirements IBA Moscow was restricted from attracting deposits from individuals. On December 1, 2004, IBA Moscow obtained a licence from the CBRF allowing it to provide a full range of banking services to individuals. IBA Moscow's principal activity is represented by commercial banking operations. IBA Moscow has been a member of Deposit Insurance Agency of the Russian Federation since December 2, 2004. IBA Moscow's registered office is located at the following address: Tverskaya 6, Bldg 2, Moscow, 105062, Russian Federation. IBA Moscow opened a branch in Saint Petersburg, Russian Federation on May 28, 2003 and in Yekaterinburg on August 24, 2005.

Based on the decision of Supervisory Board of the Group dated December 30, 2006 and May 18, 2011, the share capital of IBA Moscow was increased by EUR 4 million and AZN 10 million, respectively, during the years ended December 31, 2007 and year ended December 31, 2011, respectively.

On February 5, 2002, the Group registered its fully-owned subsidiary International Insurance Company ("Insurance Subsidiary") at the Ministry of Justice of the Republic of Azerbaijan. The Insurance Subsidiary operates under an insurance licence issued by the Ministry of Finance of the Republic of Azerbaijan on October 15, 2009. The Insurance Subsidiary is licensed to perform a total of 33 types of insurance activities. The insurance business underwritten by the Company includes medical, auto, marine third party liability, marine hull, property, casualty, life, personal insurance, insurance banking risks, mandatory fire insurance, insurance of liability for non-performance of obligations and reinsurance. The registered office of the Insurance Subsidiary is located at 40C, J.Jabbarli Street, Baku, AZ 1065, the Republic of Azerbaijan.

Azericard Limited, which is 100% owned by the Bank, was established as a limited liability company on May 3, 1996. Azericard Limited was registered with the Ministry of Justice of the Republic of Azerbaijan on July 4, 1996 and commenced its operations in 1997. Azericard Limited is a member service provider for MasterCard and Visa International and acts as a clearing and authorisation centre for plastic card transactions in the Republic of Azerbaijan.

Azericard Limited is at present one of the biggest providers of authorisation of plastic cards operations and clearing services in the Republic of Azerbaijan. The registered office address of Azericard Limited is: Nizami Street, 67, AZ1005, Baku, the Republic of Azerbaijan.

On November 16, 2006, the Group registered its 75% owned subsidiary, International Bank of Azerbaijan Republic - Georgia ("IBA Georgia"), in Tbilisi, Georgia. The share capital of IBA Georgia was established in the amount of 12,000,000 Georgian Laris ("GL"), with the non-controlling interest in the amount of GL 3,000,000 paid-in equally by an Azerbaijani commercial bank and a resident individual of the Republic of Georgia. IBA Georgia started its operations under a license issued by the National Bank of Georgia ("the NBG") on February 5, 2007. IBA Georgia's registered office is located at the following address: 36 Khetagurovi str., Tbilisi, Republic of Georgia. Based on the decision of Supervisory Board of the Group dated May 18, 2011, the share capital of IBA Georgia was increased by AZN 3,750 thousand during the year ended December 31, 2011, total increase in share capital was AZN 5,000 thousand, remaining part was paid by other shareholders of IBA Georgia.

These consolidated financial statements were authorized for issue on June 29, 2012 by the Board of Directors.

2. GOING CONCERN

Management has prepared these consolidated financial statements on a going concern basis. In making this judgement, management has considered current intentions, the profitability of operations and access to financial resources.

For the year ended December 31, 2011 the Group has returned to profitability and made a profit after tax of AZN 19,561 thousand (2010: a loss after tax of AZN 110,605 thousand) and has cash outflows from operating activities amounting to AZN 182,016 thousand (2010: AZN 189,414 thousand).

Whilst returning to profitability in 2011 the group had, as set out in the contractual maturity table in Note 26, as at December 31, 2011, a negative cumulative liquidity gap of AZN 875,968 thousand in the period up to twelve months (2010: AZN 706,140 thousand). Furthermore, as discussed in Note 28, as at December 31, 2011 the Group was not in compliance with certain financial covenants included in term borrowing arrangements, which resulted in outstanding debt under these borrowing agreements being classified as in breach. Accordingly, AZN 344,750 thousand of borrowings have been reclassified as being on demand within these consolidated financial statements (2010: AZN 445,620 thousand of borrowings and AZN 15,958 thousand of subordinated debt).

Also the Group, as set out in the Management of Capital note, Note 27, as at December 31, 2011, has a Total Capital Ratio of 7.60% (2010: 8.25%). The Group was not in compliance with total capital adequacy ratio by the Basel I of 8% as at December 31, 2011 and at certain other times during the reporting year.

As can be seen in Note 7 the effective provision rate of the Group against its loans and advances to customers has decreased to 14.68% (2010: 16.54%). For customers in the Republic of Azerbaijan, the Group has seen the probability of default decreasing as a result of the improving economic conditions within the country during the year, impacting on the Group's customers' ability to service their debt obligations. Whilst for those customers in the Russian Federation, who were engaged in long-term real estate development projects, during the year, the Group has been able to assess the necessary impairment provisions against these projects, therefore recognising an increase in the charge for impairment provisions.

With regards to the breach of covenants the Group is in continuous discussion with its international lenders to seek waivers and where possible extend credit terms. For a number of borrowings the Group has to date successfully renegotiated, extended or renewed these borrowings and/or facilities.

To improve Capital Adequacy Ratios the Shareholders of the Group, as disclosed in Note 31, decided to increase share capital of the Group by AZN 100,000 thousand and in addition the Central Bank of the Republic of Azerbaijan has provided the Group with Subordinated Debt amounting to AZN 150,000 thousand.

In addition Management is considering other means by which it can attract both Equity and/or Subordinated Debt funding for the Group, which will enhance its Total Capital and ensure future compliance with Capital Adequacy Ratios set by the CBAR.

While recent global events have had a significant impact on the ability of the Group to obtain new or extended term borrowings from local and international financial institutions, and where available, the cost of funding has typically increased, management are actively managing this position. Management believes that the international financial institutions will not take adverse actions against the Group due to non-compliance with covenants. Refer to Note 28 where the management of the Group is continuing negotiations with international financial institutions to obtain new debt financing.

As a result of management's assessment and the actions being undertaken, management believes that the Group will be able to cover its liquidity needs over the next twelve months and beyond. Therefore they decided it is appropriate that these consolidated financial statements are prepared under the going concern assumption.

3. SIGNIFICANT ACCOUNTING POLICIES

Statement of Compliance

These consolidated financial statements 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").

Other basis of presentation criteria

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

These consolidated financial statements are presented in thousands of Azerbaijan Manats ("AZN"), unless otherwise indicated. These consolidated financial statements have been prepared on the historical cost basis except for certain properties and financial instruments that are measured at revalued amounts or fair values, as explained in the accounting policies below. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

The Bank and its consolidated companies, registered in the Republic of Azerbaijan, maintain their accounting records in accordance with local accounting practice, foreign consolidated companies of the Bank maintain their accounting records in accordance with the law of the countries, in which they operate. These consolidated financial statements have been prepared from the statutory accounting records and have been adjusted to conform to IFRS.

The Group presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the reporting date (current) and more than 12 months after the reporting date (non current) is presented in Note 26.

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expense is not offset in the consolidated statement of comprehensive income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

The principal accounting policies are set out below.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and entities controlled by the Bank (its subsidiaries). Control is achieved where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated in full on consolidation.

Non-controlling interests

Non-controlling interests represent the portion of profit or loss and net assets of subsidiaries not owned, directly or indirectly, by the Bank.

Non-controlling interests are presented separately in the consolidated statement of comprehensive income and within equity in the consolidated statement of financial position, separately from parent shareholders' equity.

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 receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Income is recognised on an effective interest basis for debt instruments other than those financial assets classified as at FVTPL.

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 revenue – other

Recognition of fee and commission income

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

Financial instruments

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

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 or loss.

Financial assets

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

Financial assets at FVTPL

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

A financial asset is classified as held for trading if:

- It has been acquired principally for the purpose of selling it in the near term; or
- On initial recognition it is part of a portfolio of identified financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- The financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives, and IAS 39 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned on the financial asset and is included in the 'other gains and losses' line item in the consolidated statement of income statement. Fair value is determined in the manner described in Note 29.

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity. Held-to-maturity investments are measured at amortised cost using the effective interest method less any impairment.

If the Group were to sell or reclassify more than an insignificant amount of held–to–maturity investments before maturity (other than in certain specific circumstances), the entire category would be tainted and would have to be reclassified as available–for–sale. Furthermore, the Group would be prohibited from classifying any financial asset as held to maturity during the following two years.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated as available-for-sale or are not classified as (a) loans and receivables, (2) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

AFS equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less any identified impairment losses at the end of each reporting period.

Loans and receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For listed and unlisted equity investments classified as AFS, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

For all other financial assets, objective evidence of impairment could include:

- Significant financial difficulty of the issuer or counterparty; or
- Breach of contract, such as default or delinquency in interest or principal payments; or
- It becoming probable that the borrower will enter bankruptcy or financial re-organisation; or
- Disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial asset, such as loans and receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of loans and receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortised cost, the amount of the impairment loss recognised is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

For financial assets carried at cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment loss will not be reversed in subsequent periods.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of loans and receivables, where the carrying amount is reduced through the use of an allowance account. When a loan or a receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognised in other comprehensive income are reclassified to profit or loss in the period.

For financial assets measured at amortized cost, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

In respect of AFS equity securities, impairment losses previously recognized in profit or loss are not reversed through profit or loss. Any increase in fair value subsequent to an impairment loss is recognized in other comprehensive income and accumulated under the heading of investments revaluation reserve. In respect of AFS debt securities, impairment losses are subsequently reversed through profit or loss if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

Write off of loans and advances

Loans and advances are written off against the provision for loan impairment when deemed uncollectible. Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Group and after the Group has sold all available collateral. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in the consolidated statement of comprehensive income in the period of recovery.

Derecognition of financial assets

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

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

A financial asset is derecognized when it has been transferred and the transfer qualifies for derecognition. A transfer required that the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to receive the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Group reassesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. If substantially all the risks and rewards have been retained, the asset remains on the statement of financial position. If substantially all of the risks and rewards have been transferred, the asset is derecognized. If substantially all the risks and rewards have been neither retained nor transferred, the Group assesses whether of not it has retained control of the asset. If it has not retained control, the asset is derecognized. Where the Group retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement.

Financial liabilities and equity instruments issued

Classification as debt or equity

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

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

Repurchase of the Bank's own equity instruments is recognized and deducted directly in equity. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Bank's own equity instruments.

Financial liabilities

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

Financial liabilities at FVTPL

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

A financial liability is classified as held for trading if:

- It has been acquired principally for the purpose of repurchasing it in the near term; or
- On initial recognition it is part of a portfolio of identified financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

A financial liability other than a financial liability held for trading may be designated as at FVTPL upon initial recognition if:

- Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- The financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives, and IAS 39 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial liabilities at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any interest paid on the financial liability and is included in the 'other gains and losses' line item in the consolidated statement of income statement. Fair value is determined in the manner described in Note 29.

Other financial liabilities

Other financial liabilities, including depository instruments with the Central Bank of the Republic of Azerbaijan, deposits by banks and customers, debt securities issued, other borrowed funds and other liabilities are initially measured at fair value, net of transaction costs.

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

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

Derecognition of financial liabilities

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit and loss.

Financial guarantee contracts

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

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

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

Derivative financial instruments

The Group enters into a variety of derivative forward contracts on foreign currency to manage its exposure to foreign exchange rate risk.

Derivatives are initially recognised at fair value at the date the derivative contract is entered into and are subsequently remeasured to their fair value at the end of each reporting period. The resulting gain or loss is recognised in profit or loss immediately.

Cash and cash equivalents

Cash and cash equivalents are items, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. All short-term inter-bank placements, beyond overnight placements, are included in due from other banks. Amounts, which relate to funds that are of a restricted nature, are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

Mandatory cash balances held with the CBAR, CBRF and NBG

Mandatory cash balances with the CBAR, CBRF and NBG are carried at amortised cost and represent non-interest bearing mandatory reserve deposits, which are not available to finance the Group's day to day operations and hence are not considered as part of cash and cash equivalents for the purposes of the consolidated statement of cash flows.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessee

Assets held under finance leases are initially recognised as assets of the Group 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 consolidated 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 recognised immediately in profit or loss unless they are directly attributable to qualifying assets, in which case they are capitalized in accordance with the Group's general policy on borrowing costs. Contingent rentals are recognised as expenses in the periods in which they are incurred.

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

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

Premises and equipment

Premises held for use in the production or supply of goods or services, or for administrative purposes, are stated in the consolidated statement of financial position at their revalued amounts, being the fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amounts do not differ materially from those that would be determined using fair values at the end of each reporting period.

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

Properties in the course of construction for production, supply or administrative purposes are carried at cost, less any recognised impairment loss. Cost includes professional fees and, for qualifying assets, borrowing costs capitalised in accordance with the Group's accounting policy. Such properties are classified to the appropriate categories of premises and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

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

Freehold land is not depreciated.

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

Depreciation is recognised so as to write off the cost or valuation of assets (other than freehold land and properties under construction) less their residual values over their useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following annual rates:

Premises	2.5%-5%
Leasehold improvements	5-10%
Office and computer equipment	25%
Plastic cards operations equipment	33%
Banking equipment, furniture, fixtures, vehicles & toher	20%-25%

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

Intangible assets

Intangible assets acquired separately

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

Derecognition of intangible assets

An intangible asset is derecognised on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognised in profit or loss when the asset is derecognised.

Impairment of non-financial assets

At the end of each reporting period, the Group reviews the carrying amounts of its tangible and definitely-lived intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

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

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 recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Taxation

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

Current tax

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

Deferred tax

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised 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 taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

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

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Current and deferred tax for the year

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively. Where current tax or deferred tax arises from the initial accounting for a business combination, the tax effect is included in the accounting for the business combination.

Operating taxes

Countries where the Group operates also have various other taxes, which are assessed on the Group's activities. These taxes are included as a component of operating expenses in the consolidated statement of comprehensive income.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

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

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

Contingencies

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

Insurance operations

Insurance contracts – classification

The Group issues contracts that transfer insurance risks. Insurance contracts are those that transfer significant insurance risk. As a general guideline, the Group defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event that are at least 10% more than the benefits payable if the insured event did not occur.

Premiums

Upon inception of the contract, the total premiums to be received over the term of the policy coverage are recorded as written and are earned primarily on a pro-rata basis over the term of the related policy coverage. The reserve for unearned premiums represents the proportion of premiums written in the year that relate to unexpired terms of policies in force at the end of the reporting period, calculated on a time apportionment basis.

Losses

Losses including loss adjustment expenses are charged to the consolidated statement of comprehensive income as incurred. Reserves for losses represent the accumulation of estimates for incurred losses and include two types of reserves: reserve for reported but not settled losses ("RBNS") and reserve for incurred but not reported losses ("IBNR"). RBNS reserve is calculated for each unsettled claim. The estimation is made on the basis of information received by the Group during investigation of insurance cases to be settled after the end of the reporting period.

If the amount of loss is not determined, the maximum possible amount of losses not exceeding the insurance limit, stated in the insurance policy, is accepted as RBNS. IBNR is established based on actuarial methods used to determine loss development patterns based on historic information, implied expected ultimate loss ratios and implied reported claims development factors. IBNR is calculated by the Group for each line of business; the calculation includes assumptions based on prior years' claims and claims handling experience. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. The methods of determining such estimates and establishing the resulting provisions are continually reviewed and updated. Resulting adjustments are reflected in the consolidated statement of comprehensive income (as a decrease or increase in profit before tax) as they arise. Loss provision reserve is estimated on an undiscounted basis due to the relatively quick pattern of claims notification and payment.

Reinsurance

The Group assumes and cedes reinsurance in the normal course of business. Ceded reinsurance contracts do not relieve the Group from its obligations to policyholders. Reinsurance receivables include balances due from reinsurance companies for paid claims, including claims handling expenses and premiums receivable ceded to the Group. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Reinsurance payables are obligations of the Group for the transfer of reinsurance premiums to reinsurers.

Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the entity's functional currency (foreign currencies) are recognised at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences on monetary items are recognised in profit or loss in the period in which they arise except for:

- Exchange differences on foreign currency borrowings relating to assets under construction for future productive use, which are included in the cost of those assets when they are regarded as an adjustment to interest costs on those foreign currency borrowings;
- Exchange differences on transactions entered into in order to hedge certain foreign currency risks (see below for hedging accounting policies); and
- Exchange differences on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur (therefore forming part of the net investment in the foreign operation), which are recognised initially in other comprehensive income and reclassified from equity to profit or loss on repayment of the monetary items.

For the purposes of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into AZN using exchange rates prevailing at the end of each reporting period. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during that period, in which case the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are recognised in other comprehensive income and accumulated in equity (attributed to non-controlling interests as appropriate).

On the disposal of a foreign operation (i.e. a disposal of the Group's entire interest in a foreign operation, or a disposal involving loss of control over a subsidiary that includes a foreign operation, a disposal involving loss of joint control over a jointly controlled entity that includes a foreign operation, or a disposal involving loss of significant influence over an associate that includes a foreign operation), all of the exchange differences accumulated in equity in respect of that operation attributable to the owners of the Group are reclassified to profit or loss.

In the case of a partial disposal that does not result in the Group losing control over a subsidiary that includes a foreign operation, the proportionate share of accumulated exchange differences are re-attributed to non-controlling interests and are not recognised in profit or loss. For all other partial disposals (i.e. reductions in the Group's ownership interest in associates or jointly controlled entities that do not result in the Group losing significant influence or joint control), the proportionate share of the accumulated exchange differences is reclassified to profit or loss.

Goodwill and fair value adjustments on identifiable assets and liabilities acquired arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the rate of exchange prevailing at the end of each reporting period. Exchange differences arising are recognised in equity.

The exchange rates used by the Group in the preparation of the consolidated financial statements as at year-end are as follows:

	December 31, 2011	December 31, 2010
AZN/1 US Dollar	0.7865	0.7979
AZN/1 Euro	1.0178	1.0560
AZN/1 Russian Rouble	0.0245	0.0263

Collateral

The Group obtains collateral in respect of customer liabilities where this is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the Group a claim on these assets for both existing and future customer liabilities.

Repossessed collateral is measured at the lower of their previous carrying amount and fair value less costs to sell.

Equity reserves

The reserves recorded in equity (other comprehensive income) on the Group's consolidated statement of financial position include:

- 'Cumulative transaction reserve' which is used to record exchange differences arising from the translation of the net investment in foreign operations, net of the effects of hedging;
- 'Revaluation reserve for premises' which includes change in fair value of buildings.

Investments in associates

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in these consolidated financial statements using the equity method of accounting, except when the investment is classified as held for sale, in which case it is accounted for in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations. Under the equity method, an investment in an associate is initially recognised in the consolidated statement of financial position at cost and adjusted thereafter to recognise the Group's share of the profit or loss and other comprehensive income of the associate. When the Group's share of losses of an associate exceeds the Group's interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognising its share of further losses. Additional losses are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of an associate recognised at the date of acquisition is recognised as goodwill, which is included within the carrying amount of the investment. Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss.

The requirements of IAS 39 are applied to determine whether it is necessary to recognise any impairment loss with respect to the Group's investment in an associate. When necessary, the entire carrying amount of the investment (including goodwill) is tested for impairment in accordance with IAS 36 Impairment of Assets as a single asset by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount. Any impairment loss recognised forms part of the carrying amount of the investment. Any reversal of that impairment loss is recognised in accordance with IAS 36 to the extent that the recoverable amount of the investment subsequently increases.

When a group entity transacts with its associate, profits and losses resulting from the transactions with the associate are recognised in the Group' consolidated financial statements only to the extent of interests in the associate that are not related to the Group.

Critical accounting judgements and key sources of estimation uncertainty

In the application of the Group's accounting policies, which are described in Note 3, the directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Key sources of estimation uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Impairment of loans and receivables

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

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

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

As at December 31, 2011 and 2010 the gross loans and receivables totaled AZN 4,697,693 thousand and AZN 3,957,931 thousand, respectively, and provision for loan impairment amounted to AZN 689,509 thousand and AZN 645,500 thousand, respectively.

Valuation of financial instruments

As described in Note 29, the Bank uses valuation techniques that include inputs that are not based on observable market date to estimate the fair value of certain types of financial instruments. Note 29 provides detailed information about the key assumptions used in the determination of the fair value of financial instruments, as well as the detailed sensitivity analysis for these assumptions. The directors believe that the chosen valuation techniques and assumptions used are appropriate in determining the fair value of financial instruments.

Useful lives of property and equipment

As described in Note 3 above, the Group reviews the estimated useful lives of premises and equipment at the end of each annual reporting period.

Premises carried at revalued amounts

Premises are measured at revalued amounts. The date of the latest appraisal was June 30, 2011. The next revaluation is preliminary scheduled as at June 30, 2013. The carrying value of revalued property amounted to AZN 48,634 thousand and AZN 45,486 thousand as at December 31, 2011 and 2010, respectively.

Recoverability of deferred tax assets

The management of the Group is confident that no valuation allowance against deferred tax assets at the reporting date is considered necessary, because it is more likely than the deferred tax asset will be fully realized. The carrying value of deferred tax assets amounted to AZN 38,728 thousand and AZN 49,412 thousand as at December 31, 2011 and 2010, respectively.

Other borrowed funds

Management has considered whether gains or losses should arise on initial recognition of loans from international financial institutions in the amount of AZN 755,870 thousand as at December 31, 2011 (December 31, 2010: AZN 825,657 thousand) and related lending. The Bank obtains long term financing from international financial institutions at interest rates, at which such institutions ordinarily lend in emerging markets and which may be lower than rates, at which the Bank could source the funds from local lenders. The amount of such borrowings as at December 31, 2011 was AZN 215,307 thousand (December 31, 2010: AZN 361,081 thousand). As a result of such financing, the Bank is able to advance funds to specific customers at advantageous rates.

As the transactions are with unrelated parties, management's judgement is that these funds and the related lending are at the market interest rates and no initial recognition of gains or losses should arise. In making this judgement management also considered that these instruments are a separate market segment.

Loans at low interest rates

Management has considered the appropriate market interest rate for certain loans and advances where the contractual interest rate is eight per cent or lower. The amount of such loans as at December 31, 2011 was AZN 408,462 thousand (December 31, 2010: AZN 1,003,935 thousand). Management have assessed that the contractual interest rates for these loans are equivalent to the alternative highest and best use of the funds provided under these loans, the majority of which are with Government bodies and state-owned entities. Had management concluded that the interest rates for these borrowings were different to the highest and best use of the funds provided, then the carrying amounts in respect of these loans in the consolidated financial statements, and the amounts recorded within interest income and losses on the origination of loans, would have been different.

Loans to customers engaged in long-term real estate development projects

Included in the Group loans and advances as at December 31, 2011, are loans and advances outstanding in the amount of AZN 477,274 thousand to a number of companies operating in the Russian Federation engaged in long-term real estate development projects (December 31, 2010: AZN 377,095 thousand). As at December 31, 2011, the Group had AZN 194,873 thousand of provision for impairment against these loans based on the assumption that additional long-term funding would be available to complete these projects (December 31, 2010: AZN 148,419 thousand). As of the date of this audit opinion, the management of the Group believes that the necessary financial resources will be available to finance these long-term projects through to completion.

The Group has collateral agreements with loans to customers engaged in real estate development projects in Russia, mainly Moscow region, where those loan customers pledged their ordinary shares as collateral against the loans issued. The fair value of such collaterals was deemed to be equal to its nominal value, which is immaterial for these consolidated financial statements, as it is impracticable to determine their fair values as at December 31, 2011 and December 31, 2010.

Tax legislation

Azerbaijani, Russian and Georgian tax, currency and customs legislation is subject to varying interpretations. Refer to Note 28.

Initial recognition of related party transactions

In the normal course of business the Group enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis. The information on related party balances is disclosed in Note 30.

Capital Adequacy ratio

Capital Adequacy Ratio is calculated in accordance with the International Convergence of Capital Measurement and Capital Standards (July 1988, updated to November 2005) (or Basel Capital Accord) requirements. Such requirements are subject to interpretation and accordingly the appropriateness of the inclusion, exclusion, and/or classification of amounts included in the calculation of the Capital Adequacy Ratio requires management judgment, for example, whether the off-balance sheet commitments covered by blocked customer accounts would carry 0% risk for the purposes of calculating total risk-weighted assets. Currently, management believes that such off-balance sheet commitments carry 0% risk for the capital adequacy calculation purposes.

Deferred Taxation

On November 14, 2008, a new Law on "Stimulation of Increasing the Capitalization of Banks, Insurance and Reinsurance Companies" (the "Law") was enacted. According to the Law the profit tax rate for banks, insurance and reinsurance companies is reduced to 0% for three fiscal years starting from January 1, 2009, for the portion of the profit which is transferred to share capital. Management of the Bank considered the impact of the enactment of the Law on the Group's deferred tax calculation. As Management is not expecting to transfer any portion of the current year profit to share capital in 2011, the Bank will not be able to utilise the benefits of this. Therefore, the Bank recognised deferred taxes for all temporary taxable and deductible differences as at December 31, 2011.

Liquidity mismatch

As disclosed in Note 26 to these consolidated financial statements, the Group has a cumulative negative liquidity gap up to twelve months as at December 31, 2011 and as at December 31, 2010. Management is confident that the Group will be able to obtain required funds in order to replace attracted liabilities with duration of up to twelve months. In particular, management believes that the continued support of its shareholders and access to borrowings from international financial institutions means that the Group would be able to obtain appropriate resources should all liabilities require settlement as disclosed in Note 26. Management's ongoing discussions with its current lenders have reaffirmed management's view that the borrowings subjected to covenants as detailed in Notes 15, 18 and 28 will not in practice require repayment prior to the contractual dates.

4. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRSs)

The Group has adopted the following new or revised standards and interpretations issued by International Accounting Standards Board and the International Financial Reporting Interpretations Committee (the IFRIC) which became effective for the Group's annual consolidated financial statement for the year ended December 31, 2011:

- IFRS 3 (2008) "Business Combinations" / IAS 27 "Consolidated and Separate Financial Statements" — amendments resulting from May 2010 Annual Improvements to IFRSs: 1) transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS; 2) clarification on measurement of non-controlling interests;
- IFRS 7 "Financial Instruments: Disclosures" — amendments resulting from May 2010 Annual Improvements to IFRSs: clarification of disclosures and release of requirement for disclosure regarding restructured loans;
- IAS 24 "Related Party Disclosures" — (as revised in 2009) modifies the definition of a related party and simplifies disclosures for government-related entities.
- Amendment to IAS 32 "Classification of Rights Issues" — under the amendment, rights issues of instruments issued to acquire a fixed number of an entity's own non-derivative equity instruments for a fixed amount in any currency and which otherwise meet the definition of equity are classified as equity. There was no effect on the Group's consolidated financial statements related to this amendment as there are no such instruments;
- IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments" — the Interpretation provides guidance on the accounting for 'debt for equity swaps' from the perspective of the borrower. There was no effect on the Group's consolidated financial statements related to this IFRIC as there are no such transactions.

The adoption of the new or revised standards did not have any effect on the financial position or performance of the Group, and all have been retrospectively applied in compliance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors", unless otherwise noted below.

An amendment to IAS 24 Related Party Disclosures – The revised Standard modifies the definition of a related party and simplifies disclosures for Government-related entities. Since the Group is ultimately controlled by the Government of the Republic of Azerbaijan the disclosure exemptions introduced in IAS 24 are applicable for the Group consolidated financial statements commencing from the year ended December 31, 2011.

3.1 New and revised IFRSs in issue but not yet effective

At the date of authorization of this financial information, the following new standards and interpretations were in issue, but not yet effective, and which the Group has not early adopted:

IFRS 7 "Financial Instruments: Disclosures" — amendments enhancing disclosures about transfers of financial assets[1];

IFRS 7 "Financial Instruments: Disclosures" – amendments enhancing disclosures about offsetting financial assets and financial liabilities[2];

IFRS 9 "Financial Instruments"[6];

IFRS 10 "Consolidated Financial Statements" [3];

IFRS 11 "Joint Arrangements" [3];

IFRS 12 "Disclosure of Interest in Other Entities" [3];

IFRS 13 "Fair Value Measurement" [2];

IAS 1 "Presentation of Financial Statements" — amendments to revise the way other comprehensive income is presented[4];

IAS 1 "Presentation of Financial Statements" — amendments to clarify the requirements for comparative information[2];

IAS 12 "Income Taxes" — limited scope amendment (recovery of underlying assets)[5];

IAS 19 "Employee Benefits" — improvements to the accounting for post-employment benefits[2];

IAS 27 - reissued as IAS 27 "Separate Financial Statements" (as amended in May 2011)[3];

IAS 28 - reissued as IAS 28 "Investments in Associates and Joint Ventures" (as amended in May 2011)[3];

IAS 32 "Financial Instruments: Presentation"– amendments which provide clarifications on the application of the offsetting rules and disclosure requirements[7].

[1] Effective for annual periods beginning on or after 1 July 2011, with earlier application permitted.

[2] Effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.

[3] Each of the five standards becomes effective for annual periods beginning on or after 1 January 2013, with earlier application permitted if all the other standards in the 'package of five' are also early applied (except for IFRS 12 that can be applied earlier on its own).

[4] Effective for annual periods beginning on or after 1 July 2012, with early adoption permitted.

[5] Effective for annual periods beginning on or after 1 January 2012, with earlier application permitted.

[6] Effective for annual periods beginning on or after 1 January 2015, with earlier application permitted.

[7] Effective for annual periods beginning on or after 1 January 2014. The new offsetting disclosure requirements are effective for annual periods beginning on or after 1 January 2013.

Amendments to IFRS 7 Financial Instruments: Disclosures – The amendments introduce additional disclosures, designed to allow users of financial statements to improve their understanding of transfer transactions of financial assets (for example, securitisations), including understanding the possible effects of any risks that may remain with the entity that transferred the assets. The amendments also require additional disclosures if a disproportionate amount of transfer transactions are undertaken around the end of a reporting period.

The Group does not expect this amendment to have a material effect on its financial position or results of operations.

IFRS 9 Financial Instruments – was 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 recognised financial assets that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* to be subsequently measured at amortised cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair 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 recognised in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. 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 or loss was recognised in profit or loss.

The Group management anticipate that IFRS 9 that will be adopted in the Group's consolidated financial statements for the annual period beginning January 1, 2015 and that the application of the new Standard will have a significant impact on amounts reported in respect of the Groups' financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of that effect until a detailed review has been completed.

IFRS 10 Consolidated Financial Statements – replaces all of the guidance on control and consolidation in IAS 27 and SIC-12 by introducing a single consolidation model for all entities based on control, irrespective of the nature of the investee (ie whether an entity is controlled through voting rights or through other contractual arrangements as is common in special purpose entities). Under IFRS 10, the single definition of control, accompanied by extensive application guidance, is based on whether an investor has:

- power over the investee;

- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect the amount of the returns.

IFRS 11 Joint Arrangements – replaces IAS 31 with new accounting requirements for joint arrangements by classifying them as either joint operations or joint ventures (the 'jointly controlled assets' classification exists no more).

- In recognising their rights and obligations arising from the arrangement, the parties should no longer focus on the legal structure of the joint arrangement, but rather on how rights and obligations are shared by them.
- A joint operation gives parties to the arrangement direct rights to the assets and obligations for the liabilities. Thus, a joint operator recognises its interest based on its involvement in the joint operation (ie based on its direct rights and obligations) rather than on the participation interest it has in the joint arrangement. A party to a 'joint operation' recognises assets, liabilities, revenues and expenses arising from the arrangement.
- A joint venture gives the parties rights to the net assets or outcome (profit or loss) of the arrangement. Joint ventures are accounted for using the equity method in accordance with IAS 28 "Investments in Associates". Entities can no longer account for an interest in a joint venture using the proportionate consolidation method. A party to a 'joint venture' recognises an investment.

IFRS 12 Disclosure of Interests in Other Entities – requires enhanced disclosures about both consolidated and unconsolidated entities in which an entity has involvement, so that financial statement users are able to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. Thus, IFRS 12 sets out the required disclosures for entities reporting under the two new standards, IFRS 10 and IFRS 11 and replaces the disclosure requirements currently found in IAS 28.

IAS 27 (2011) Separate Financial Statements – includes the provisions on separate financial statements that are left almost unchanged after the control provisions of IAS 27 have been replaced with the new IFRS 10.

IAS 28 (2011) Investments in Associates and Joint Ventures – now includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11.

The Group intends to adopt this package of standards as of December 31, 2013 and is currently assessing the impact of adoption.

IFRS 13 Fair Value Measurement – aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements to use across IFRSs. The Standard:

- defines fair value;
- sets out in a single IFRS a framework for measuring fair value;
- requires disclosures about fair value measurements.

IFRS 13 applies when another IFRS requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except for share-based payment transactions within the scope of IFRS 2 "Share-based Payment", leasing transactions within the scope of IAS 17 "Leases", and measurements that have some similarities to fair value but that are not fair value, such as net realizable value in IAS 2 "Inventories" or value in use in IAS 36 "Impairment of Assets".

The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

Amendments to IAS 1 Presentation of Financial Statements **–** revise the way other comprehensive income is presented.

The amendments to IAS 1:

- Preserve the amendments made to IAS 1 in 2007 to require profit or loss and OCI to be presented together, i.e. either as a single 'statement of profit or loss and comprehensive income', or a separate 'statement of profit or loss' and a 'statement of comprehensive income' – rather than requiring a single continuous statement as was proposed in the exposure draft
- Require entities to group items presented in OCI based on whether they are potentially reclassifiable to profit or loss subsequently. i.e. those that might be reclassified and those that will not be reclassified;
- Require tax associated with items presented before tax to be shown separately for each of the two groups of OCI items (without changing the option to present items of OCI either before tax or net of tax).

The Group does not expect this amendment to have a material effect on its financial position or results of operations.

***Amendments to IAS 1 Presentation of Financial Statements* –** clarify the requirements for comparative information. The amendments to IAS 1:

- Allow presenting comparative information in addition to the minimum comparative financial statements required by IFRSs, as long as that information is prepared in accordance with IFRSs. These comparatives need not comprise a complete set of financial statements. When this is the case, the related footnote information for those additional statements is required.
- Require presenting a third statement of financial position as at the beginning of the preceding period in addition to the minimum comparative financial statements if:
  (a) the entity applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and
  (b) the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the statement of financial position at the beginning of the preceding period.

The Group does not expect this amendment to have a material effect on its consolidated financial position or consolidated results of operations.

Amendment to IAS 12 Income Taxes – provide a presumption that recovery of the carrying amount of an asset measured using the fair value model in IAS 40 Investment Property will, normally, be through sale.

The Group does not expect this amendment to have a material effect on its financial position or results of operations.

Amendments to IAS 19 Employee Benefits – introduce significant changes to the recognition and measurement of defined benefit pension expense and termination benefits and to the disclosures for all employee benefits. The amended standard requires recognition of all changes in the net defined benefit liability (asset) when they occur, as follows: (i) service cost and net interest in profit or loss; and (ii) remeasurements in other comprehensive income.

The Group is considering the impact of the amendment on the consolidated financial statements and the timing of its application.

Amendments to IAS 32 Financial Instruments: Presentation - provide clarifications on the application of the offsetting rules, and focus on four main areas:

- the meaning of 'currently has a legally enforceable right of set-off'
- the application of simultaneous realisation and settlement
- the offsetting of collateral amounts
- the unit of account for applying the offsetting requirements.

The respective amendments to the disclosure requirements in IFRS 7 *Financial Instruments: Disclosure* require information about all recognised financial instruments that are set off in accordance with paragraph 42 of IAS 32. The amendments also require disclosure of information about recognised financial instruments subject to enforceable master netting arrangements and similar agreements even if they are not set off under IAS 32. These disclosures will allow financial statement users to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with an entity's recognised financial assets and recognised financial liabilities, on the Group's financial position.

The Group is considering the impact of these amendments on the consolidated financial statements and the timing of their application.

5. CASH AND CASH EQUIVALENTS

	December 31, 2011	December 31, 2010
Cash on hand	137,361	112,388
Cash balances with the National/Central banks (other than mandatory reserve deposits)	42,099	104,435
Correspondent accounts and overnight placements with other banks		
- The Republic of Azerbaijan	2,766	2,394
- Other countries	209,155	458,613
Total cash and cash equivalents	**391,381**	**677,830**

Included in cash balances with the National/Central banks (other than mandatory reserve deposits) are the balances on correspondent accounts of the Bank and its subsidiaries, IBA Moscow and IBA Georgia, with the CBAR, CBRF and NBG amounting to AZN 26,427 thousand, AZN 14,443 thousand and AZN 1,229 thousand as at December 31, 2011 (December 31, 2010: AZN 95,310 thousand, AZN 8,959 thousand and AZN 166 thousand), respectively.

As at December 31, 2011 overnight placements with other banks was AZN 89,705 thousand with interest rate ranging between 0.01% and 0.25% per annum (December 31, 2010: overnight placements with other banks was AZN 406,106 thousand with interest rate ranging between 0.22% and 0.75% per annum).

The analysis by credit quality of the cash and cash equivalents as at December 31, 2011 is as follows:

	Cash balances with the National/Central banks	Correspondent accounts and overnight placements with other banks	Total
Current and not impaired:			
- Central Bank of the Republic of Azerbaijan	26,427	-	26,427
- Central Bank of the Russian Federation	14,443	-	14,443
- National Bank of the Republic of Georgia	1,229	-	1,229
Credit ratings of counterparty banks:			
- AAA	-	13	13
- AA	-	123,044	123,044
- A	-	76,929	76,929
- BBB	-	376	376
- <BBB	-	4,743	4,743
- not rated	-	6,816	6,816
Total current and not impaired cash and cash equivalents, excluding cash on hand	**42,099**	**211,921**	**254,020**

The most recently published international rating for the Republic of Azerbaijan is BBB-/Positive (Fitch Ratings - issued on May 17, 2011), for the Russian Federation is BBB/Stable (Fitch Ratings - issued on January 16, 2012) and for the Republic of Georgia is BB-/Stable (Fitch Ratings - issued on December 15, 2011).

The analysis by credit quality of the cash and cash equivalents as at December 31, 2010 is as follows:

	Cash balances with the National/Central banks	Correspondent accounts and overnight placements with other banks	Total
Current and not impaired:			
- Central Bank of the Republic of Azerbaijan	95,310	-	95,310
- Central Bank of the Russian Federation	8,959	-	8,959
- National Bank of the Republic of Georgia	166	-	166
Credit ratings of counterparty banks:			
- AAA	-	5,868	5,868
- AA	-	6,066	6,066
- A	-	345,809	345,809
- BBB	-	99,680	99,680
- <BBB	-	804	804
- not rated	-	2,780	2,780
Total current and not impaired cash and cash equivalents, excluding cash on hand	**104,435**	**461,007**	**565,442**

In the above tables for an analysis of credit quality of cash and cash equivalents, the management listed the classes of the banks in the order from highest to lowest credit quality as used for the purposes of internal monitoring and assessment.

Geographical, currency, liquidity and interest rate analyses of cash and cash equivalents are disclosed in Note 26. The information on related party balances is disclosed in Note 30.

6. DUE FROM OTHER BANKS

	December 31, 2011	December 31, 2010
Term placements with other banks	105,394	134,497
Less: Provision for impairment	(3,729)	(3,135)
Total due from other banks	**101,665**	**131,362**

As at December 31, 2011 term placements with other banks include two short-term foreign currency denominated placements with non-resident banks in the total amount equivalent to AZN 80,787 thousand at annual interest rates of 0.0% and 1.65%, respectively. Term placements mature in January and April 2012 (December 31, 2010: two short-term foreign currency denominated placements with non-resident banks in the total amount equivalent to AZN 82,758 thousand at annual interest rates of 0.0% and 1.5%, respectively. Term placements mature in January and April 2011).

The analysis by credit quality of amounts due from other banks outstanding as at December 31, 2011 is as follows:

	Term placements with other banks
Current and not impaired	
- BBB rated	11,840
- < BBB rated	81,345
- not rated	6,891
Total current and not impaired	100,076
Balances individually assessed for impairment (gross)	
- less than 30 days overdue	1,888
- over 360 days overdue	3,430
Total balances individually assessed for impairment (gross)	5,318
Less: Provision for impairment	(3,729)
Total due from other banks	**101,665**

The analysis by credit quality of amounts due from other banks outstanding as at December 31, 2010 is as follows:

	Term placements with other banks
Current and not impaired	
- AA rated	8,015
- BBB rated	12,085
- < BBB rated	68,860
- not rated	36,458
Total current and not impaired	125,418
Balances individually assessed for impairment (gross)	
- less than 30 days overdue	5,794
- 30 to 90 days overdue	636
- over 360 days overdue	2,649
Total balances individually assessed for impairment (gross)	9,079
Less: Provision for impairment	(3,135)
Total due from other banks	**131,362**

In the above tables for an analysis of credit quality of due from other banks, the management listed the classes of the banks in the order from highest to lowest credit quality as used for the purposes of internal monitoring and assessment.

The primary factor that the Group considers whether a due from other banks balance is impaired is its overdue status. As a result, the Group presented the above ageing analysis of deposits that are individually determined to be impaired.

Movements in the provision for impairment of due from other banks were as follows:

	Due from other banks
December 31, 2009	7,339
Additional provisions recognized	5,329
Write-off of assets	(9,533)
December 31, 2010	3,135
Additional provisions recognized	594
December 31, 2011	**3,729**

The carrying value and fair value of due from other banks is disclosed in Note 29.

Geographical, currency, liquidity and interest rate analyses of due from other banks is disclosed in Note 26.

7. LOANS AND ADVANCES TO CUSTOMERS

	December 31, 2011	December 31, 2010
Corporate loans	4,178,051	3,487,294
State and public organisations	10,935	8,136
Loans to individuals – consumer loans	269,351	258,064
Loans to individuals – purchase of motor vehicles	85,478	74,518
Loans to individuals – employees	59,523	51,197
Loans to individuals – mortgage loans	26,904	17,444
Loans to individuals – other purposes	67,451	61,278
	4,697,693	3,957,931
Less: Provision for loan impairment	(689,509)	(654,500)
Total loans and advances to customers	**4,008,184**	**3,303,431**

Movements in the provision for loan impairment during 2011 are as follows:

	Provision for loan impairment as at December 31, 2010	Increase in/ (recovery of) provision for impairment during the year	Effect of foreign currency exchange recognized	Provision for loan impairment as at December 31, 2011
Corporate loans	585,072	42,435	(2,093)	625,414
State and public organisations	4,488	(4,607)	227	108
Loans to individuals – consumer loans	44,246	(19,186)	946	26,006
Loans to individuals – purchase of motor vehicles	3,370	(2,621)	129	878
Loans to individuals – employees	3,867	13,266	(654)	16,479
Loans to individuals – mortgage loans	2,801	(11)	1	2,791
Loans to individuals – other purposes	10,656	7,549	(372)	17,833
Total	**654,500**	**36,825**	**(1,816)**	**689,509**

Movements in the provision for loan impairment during 2010 are as follows:

	Provision for loan impairment as at December 31, 2009	Increase in/ (recovery of) provision for impairment during the year	Write off of assets	Provision for loan impairment as at December 31, 2010
Corporate loans	356,057	229,222	(207)	585,072
State and public organisations	7,130	(2,642)	-	4,488
Loans to individuals – consumer loans	13,816	30,430	-	44,246
Loans to individuals – purchase of motor vehicles	4,511	(1,141)	-	3,370
Loans to individuals – employees	1,663	2,204	-	3,867
Loans to individuals – mortgage loans	902	1,899	-	2,801
Loans to individuals – other purposes	18,775	(8,119)	-	10,656
Total	**402,854**	**251,853**	**(207)**	**654,500**

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

	December 31, 2011 Amount	%	December 31, 2010 Amount	%
Trade and service	1,703,531	36.3	1,432,113	36.2
Construction and real estate development	1,396,916	29.7	1,069,566	27.0
Manufacturing	683,173	14.6	560,413	14.2
Individuals	508,707	10.8	462,501	11.7
Railroad and other transportation	145,257	3.1	142,881	3.6
Oil and gas sector, Power production and distribution	78,396	1.7	82,616	2.1
Air transportation	47,027	1.0	60,219	1.5
Leasing companies	27,559	0.6	30,061	0.8
Communication	19,427	0.4	36,105	0.9
State and public organisations*	10,935	0.2	8,136	0.2
Other	76,765	1.6	73,320	1.8
Total loans and advances to customers (before impairment)	**4,697,693**	**100.0**	**3,957,931**	**100.0**

(*) State and public organisations include ministries, the Treasury and other state bodies of the Republic of Azerbaijan, excluding profit making state and public organisations that are included in the respective categories.

Included in the gross amount of total loans and advances to customers as at December 31, 2011, are the loans granted to twenty companies amounting to AZN 1,397,449 thousand (December 31, 2010: to twenty companies amounting to AZN 1,216,452 thousand) and representing a concentration of 29.7% (December 31, 2010: 30.7%) of the total loan portfolio of the Group.

Included in the gross amount of total loans and advances to customers as at December 31, 2011, are the loans granted to government institutions and state enterprises of the Republic of Azerbaijan amounting to AZN 239,462 thousand (December 31, 2010: AZN 240,756 thousand) and representing 5.1% (December 31, 2010: 6.1%) of the total loan portfolio of the Group.

Included in the gross amount of total loans and advances to customers as at December 31, 2011, are the loans granted to fifteen borrowers amounting to AZN 317,131 thousand (December 31, 2010: fifteen borrowers, AZN 490,375 thousand) with interest rates being less than or equal to eight per cent and representing 6.8% (December 31, 2010: 12.4%) of the total gross loan portfolio of the Group. The majority of these loans are transactions with related parties and as such disclosed in Note 30. No adjustments have been made to the contractual interest rates in relation to these amounts on initial recognition at fair value as the interest rates applicable are considered to represent the highest and best use of the funds provided given the alternative uses by the Bank of the funds extended under these agreements.

Included in the gross amount of total loans to individuals as at December 31, 2011 are outstanding balances drawn on credit cards of AZN 84,806 thousand (December 31, 2010: AZN 83,788 thousand).

The table below summarizes total amount of loans to customers before provision for impairment by type of collateral, rather than the fair value of collateral itself as at December 31, 2011 is as follows:

	Corporate loans	State and public organisations	Loans to individuals consumer loans	Loans to individuals - purchase of motor vehicles	Loans to individuals employees	Loans to individuals mortgage loans	Loans to individuals - other purposes	Total
Unsecured loans	1,351,507	10,935	162,781	1,859	55,103	4,498	19,245	1,605,928
Loans collateralised by:								
- real estate	1,516,094	-	51,838	40	2,610	21,674	42,018	1,634,274
- state guarantee	115,853	-	-	-	-	-	-	115,853
- corporate guarantee	135,466	-	14,478	13	3	70	131	150,161
- cash deposits	215,537	-	24,715	133	97	-	2,386	242,868
- movable property and equipment	765,103	-	1,682	83,361	125	-	266	850,537
- other	78,491	-	13,857	72	1,585	662	3,405	98,072
Total loans and advances to customers	**4,178,051**	**10,935**	**269,351**	**85,478**	**59,523**	**26,904**	**67,451**	**4,697,693**

The table below summarizes total amount of loans to customers before provision for impairment by type of collateral, rather than the fair value of collateral itself as at December 31, 2010 is as follows:

	Corporate loans	State and public organisations	Loans to individuals consumer loans	Loans to individuals - purchase of motor vehicles	Loans to individuals employees	Loans to individuals mortgage loans	Loans to individuals - other purposes	Total
Unsecured loans	1,173,765	8,128	178,120	2,531	49,527	2,066	18,828	1,432,965
Loans collateralised by:								
- real estate	1,303,767	-	39,038	49	324	15,207	40,953	1,399,338
- state guarantee	22,243	-	-	-	-	-	-	22,243
- corporate guarantee	297,682	-	9,139	5	7	40	84	307,157
- cash deposits	144,284	-	18,963	27	82	-	891	164,247
- movable property and equipment	516,713	8	648	71,778	28	81	133	589,389
- other	28,640	-	12,156	128	1,229	50	389	42,592
Total loans and advances to customers	**3,487,294**	**8,136**	**258,064**	**74,518**	**51,197**	**17,444**	**61,278**	**3,957,931**

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

	Corporate loans	State and public organisations	Loans to individuals - consumer loans	Loans to individuals - purchase of motor vehicles	Loans to individuals - employees	Loans to individuals - mortgage loans	Loans to individuals - other purposes	Total
Current and not impaired								
Loans collateralised by:								
- real estate	865,688	-	30,669	40	764	18,379	4,996	920,536
- state guarantee	50,216	-	-	-	-	-	-	50,216
- corporate guarantee	55,694	-	8,308	13	3	70	92	64,180
- cash deposits	79,327	-	13,194	133	71	-	2,074	94,799
- movable property and equipment	488,545	-	1,472	-	115	-	21	490,153
- motor vehicles	-	-	-	79,954	-	-	-	79,954
- other	32,256	-	7,712	43	1,124	662	3,383	45,180
Unsecured loans	571,042	3,057	144,684	1,287	4,457	2,684	2,877	730,088
Loans renegotiated in 2011	788,169	-	18,979	210	417	10	174	807,959
Total current and not impaired	**2,930,937**	**3,057**	**225,018**	**81,680**	**6,951**	**21,805**	**13,617**	**3,283,065**
Past due but not impaired								
- up to 90 days overdue	64,107	-	1,581	354	1	40	204	66,287
- 90 to 180 days overdue	20,962	-	435	216	1,683	-	68	23,364
- 180 to 360 days overdue	23,777	3,302	1,847	263	2,235	157	115	31,696
- over 360 days overdue	82,845	4,467	14,478	996	31,211	1,742	23,920	159,659
Total past due but not impaired	**191,691**	**7,769**	**18,341**	**1,829**	**35,130**	**1,939**	**24,307**	**281,006**
Loans individually assessed for impairment								
- up to 90 days overdue	731,117	-	4,854	-	26	105	9	736,111
- 90 to 180 days overdue	13,337	-	7,371	138	1,702	-	4,957	27,505
- 180 to 360 days overdue	74,799	-	1,395	52	723	1,583	7,117	85,669
- over 360 days overdue	184,971	109	12,198	1,768	14,978	1,472	17,264	232,760
Loans renegotiated in 2011	51,199	-	174	11	13	-	180	51,577
Total loans individually assessed for impairment	**1,055,423**	**109**	**25,992**	**1,969**	**17,442**	**3,160**	**29,527**	**1,133,622**
Less: Provision for loan impairment	**(625,414)**	**(108)**	**(26,006)**	**(878)**	**(16,479)**	**(2,791)**	**(17,833)**	**(689,509)**
Total loans and advances to customers	**3,552,637**	**10,827**	**243,345**	**84,600**	**43,044**	**24,113**	**49,618**	**4,008,184**

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

	Corporate loans	State and public organisations	Loans to individuals - consumer loans	Loans to individuals - purchase of motor vehicles	Loans to individuals - employees	Loans to individuals - mortgage loans	Loans to individuals - other purposes	Total
Current and not impaired								
Loans collateralised by:								
- real estate	737,752	-	11,755	-	311	12,208	3,569	765,595
- state guarantee	11,531	-	-	-	-	-	-	11,531
- corporate guarantee	174,304	-	6,317	-	7	40	82	180,750
- cash deposits	85,772	-	14,700	-	55	-	441	100,968
- movable property and equipment	390,632	8	340	191	25	81	44	391,321
- motor vehicles	-	-	-	70,459	-	-	-	70,459
- other	14,709	-	8,496	30	955	50	287	24,527
Unsecured loans	631,596	24	157,802	-	8,008	2,133	13,700	813,263
Loans renegotiated in 2010	419,324	-	10,912	167	80	205	55	430,743
Total current and not impaired	**2,465,620**	**32**	**210,322**	**70,847**	**9,441**	**14,717**	**18,178**	**2,789,157**
Past due but not impaired								
- up to 90 days overdue	34,962	8	1,031	16	286	9	78	36,390
- 90 to 180 days overdue	26,222	-	649	52	3	-	101	27,027
- 180 to 360 days overdue	28,379	-	834	44	10	36	181	29,484
- over 360 days overdue	18,175	-	1,820	63	240	173	411	20,882
Total past due but not impaired	**107,738**	**8**	**4,334**	**175**	**539**	**218**	**771**	**113,783**
Loans individually assessed for impairment								
- up to 90 days overdue	552,775	3,307	5,312	152	2,426	-	461	564,433
- 90 to 180 days overdue	45,557	-	1,580	55	36,954	49	165	84,360
- 180 to 360 days overdue	80,289	-	8,845	278	35	103	3,402	92,952
- over 360 days overdue	145,429	4,789	25,803	2,994	1,801	2,291	37,839	220,946
Loans renegotiated in 2010	89,886	-	1,868	17	1	66	462	92,300
Total loans individually assessed for impairment	**913,936**	**8,096**	**43,408**	**3,496**	**41,217**	**2,509**	**42,329**	**1,054,991**
Less: Provision for loan impairment	**(585,072)**	**(4,488)**	**(44,246)**	**(3,370)**	**(3,867)**	**(2,801)**	**(10,656)**	**(654,500)**
Total loans and advances to customers	**2,902,222**	**3,648**	**213,818**	**71,148**	**47,330**	**14,643**	**50,622**	**3,303,431**

In these consolidated financial statements prepared in accordance with IFRS, the Group applied the portfolio provisioning methodology prescribed by IAS 39, Financial Instruments: Recognition and Measurement, and created portfolio provisions for impairment losses that were incurred, but have not been specifically identified with any individual loan by the end of the reporting period. The Group's policy is to classify each loan as "current and not impaired" until a specific objective evidence of impairment of the loan is identified.

The primary factors that the Group considers whether a loan is impaired are its overdue status and realisability of related collateral, if any. As a result, the Group presented the above ageing analysis of loans that are individually assessed for impairment.

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

As at December 31, 2011, total estimated value of collateral was 929,326 AZN thousand (December 31, 2010: AZN 1,128,746 thousand) for past due and individually impaired corporate loans.

The following table summarizes fair value of collateral for corporate loans:

	2011	2010
Fair value of collateral for past due but not impaired loans		
- real estate	406,168	299,123
- movable property	44,641	136,599
- securities	2,924	-
- other assets	9,647	10,196
Fair value of collateral for loans individually assessed for impairment		
- real estate	393,914	582,962
- movable property	50,486	61,623
- securities	6,331	-
- other assets	15,215	38,243
Total	**929,326**	**1,128,746**

In addition to the above collaterals the Group has collateral agreements with loans to customers engaged in real estate development projects in Russia, mainly Moscow region, where those loan customers pledged their ordinary shares as collateral against the loans issued. The fair value of such collateral was deemed to be equal to its nominal value, which is immaterial for these consolidated financial statements, as it is impracticable to determine their fair values as at December 31, 2011 and December 31, 2010.

The carrying value of each class of loans and advances to customers approximates fair value as at December 31, 2011 and December 31, 2010. As at December 31, 2011, the estimated fair value of loans and advances to customers was AZN 3,886,594 thousand (December 31, 2010: AZN 3,303,431 thousand). Refer to Note 29.

Geographical, currency, liquidity and interest rate analyses analysis of loans and advances to customers is disclosed in Note 26. The information on related party balances is disclosed in Note 30.

8. INVESTMENT IN ASSOCIATES

	December 31, 2011	December 31, 2010
Joint Leasing Company	-	727
Baku Inter-Bank Currency Exchange (BICE)	649	712
Total investments in associates	**649**	**1,439**

The table below summarises the movements in the carrying amount of the Group's investment in associates:

	2011	2010
Carrying amount as at January 1	**1,439**	**1,937**
Share of loss of Joint Leasing Company	(727)	(442)
Share of loss of BICE	(63)	(56)
Carrying amount as at December 31	**649**	**1,439**

As at December 31, 2011, the Group's interests in its principal associates and their summarised financial information, including total assets, liabilities, revenues and losses, were as follows:

Name	Total assets	Total liabilities	Revenue	Loss	% interest held	Country of Incorporation
Joint Leasing Company	30,725	27,150	1,056	(4,491)	47.6	The Republic of Azerbaijan
BICE	3,020	66	231	(311)	20.0	The Republic of Azerbaijan
Total	**33,745**	**27,216**	**1,287**	**(4,802)**		

As at December 31, 2010, the Group's interests in its principal associates and their summarised financial information, including total assets, liabilities, revenues and losses, were as follows:

Name	Total assets	Total liabilities	Revenue	Loss	% interest held	Country of Incorporation
Joint Leasing Company	22,435	20,948	2,443	(929)	47.6	The Republic of Azerbaijan
BICE	3,290	9	271	(281)	20.0	The Republic of Azerbaijan
Total	**25,725**	**20,957**	**2,714**	**(1,210)**		

9. PREMISES, EQUIPMENT AND INTANGIBLE ASSETS

	Premises	Leasehold improvements	Office and computer equipment	Banking equipment, furniture, fixtures, vehicles & other	Construction in progress	Total premises and equipment	Intangible assets	Total
At initial/revalued cost								
December 31, 2009	83,460	4,403	37,847	43,788	77,263	246,761	14,134	260,895
Additions	1,038	385	9,252	1,690	6,095	18,460	2,452	20,912
Disposals	-	-	(1,354)	(1,078)	(706)	(3,138)	-	(3,138)
Transfers	(2,107)	-	-	-	2,107	-	-	-
December 31, 2010	82,391	4,788	45,745	44,400	84,759	262,083	16,586	278,669
Additions	5,666	236	4,497	1,567	76	12,042	3,689	15,731
Revaluation	3,440	-	-	-	(71)	3,369	-	3,369
Disposals	-	-	(879)	(868)	-	(1,747)	(1,094)	(2,841)
Transfers	493	230	(8,462)	(132)	7,871	-	-	-
Effect of foreign currency exchange differences	(374)	(21)	(202)	(184)	(347)	(1,128)	(59)	(1,187)
December 31, 2011	91,616	5,233	40,699	44,783	92,288	274,619	19,122	293,741
Accumulated depreciation								
December 31, 2009	(33,437)	(663)	(29,777)	(34,523)	-	(98,400)	(8,773)	(107,173)
Depreciation charge	(3,468)	(517)	(4,098)	(2,882)	-	(10,965)	(2,939)	(13,904)
Eliminated on disposal	-	-	1,195	1,078	-	2,273	-	2,273
December 31, 2010	(36,905)	(1,180)	(32,680)	(36,327)	-	(107,092)	(11,712)	(118,804)
Depreciation charge	(4,580)	(450)	(3,780)	(2,581)	-	(11,391)	(2,644)	(14,035)
Revaluation	(1,497)	-	-	-	-	(1,497)	-	(1,497)
Eliminated on disposal	-	-	875	872	-	1,747	1,094	2,841
December 31, 2011	(42,982)	(1,630)	(35,585)	(38,036)	-	(118,233)	(13,262)	(131,495)
Net book value								
As at December 31, 2011	**48,634**	**3,603**	**5,114**	**6,747**	**92,288**	**156,386**	**5,860**	**162,246**
As at December 31, 2010	**45,486**	**3,608**	**13,065**	**8,073**	**84,759**	**154,991**	**4,874**	**159,865**

As at December 31, 2011 the premises owned by the Group carried at revalued amounts based on the independent appraiser's report. As at December 31, 2011 carrying value of these building totaled AZN 48,634 thousand (December 31, 2010: AZN 45,486 thousand). As at December 31, 2011, the carrying amount of premises would have been 23,223 AZN thousand (December 31, 2010: AZN 21,970 thousand) had the assets been carried at cost less depreciation. As a result of the valuation, the net carrying amount of buildings increased by AZN 1,872 thousand, representing a revaluation increase of AZN 2,664 thousand and a revaluation decrease of AZN 792 thousand. Revaluation increase through revaluation reserve of AZN 1,807 thousand, net of deferred tax of AZN 447 thousand, and revaluation decrease of AZN 829 thousand through profit and loss statement relating to revaluation of buildings of the Bank and its subsidiaries, was recorded as an increase in comprehensive income for the year ended December 31, 2011, respectively.

Buildings owned by the Group were revalued by independent appraisers as at June 30, 2011. The following methods were used for the estimation of their fair value: discounted cash flow method (income approach) and method of sales comparison (comparative approach).

Included in the premises and equipment as at December 31, 2011 are office, computer equipment and furniture, vehicles and other assets with a cost of 62,506 AZN thousand (December 31, 2010: AZN 57,421 thousand) which have been fully depreciated but were still in use by the Group as at December 31, 2010.

Construction in progress mainly consists of construction and refurbishment of branch premises as well as payments made by the Group to contractors for the purposes of construction of its new office building on land purchased by the Group in the centre of Baku. Upon completion, assets are transferred to premises and equipment.

Intangible assets include software and licenses.

10. OTHER FINANCIAL AND INSURANCE ASSETS

	December 31, 2011	December 31, 2010
Amounts in the course of settlement and receivables for plastic cards transactions	3,747	4,299
Receivables from insurance policyholders	504	1,510
Currency swap agreements	-	502
Other	423	275
Total other financial and insurance assets	**4,674**	**6,586**

Receivables for plastic cards transactions represent receivables from other local banks for cards produced, issued and serviced for them by Azericard, the card processing subsidiary, as well as net funds receivable from other local banks for cash withdrawn from the Bank's ATMs by customers of other banks.

The analysis by credit quality of other financial and insurance receivables outstanding as at December 31, 2011 is as follows:

	Receivables from insurance policyholders	**Amounts in the course of settlement and receivable for plastic cards transactions**	**Total**
Current and not impaired			
- not rated	245	4,170	4,415
Total current and not impaired	245	4,170	4,415
Past due but not impaired			
- less than 30 days overdue	86	-	86
Total past due but not impaired	86	-	86
Receivables collectively determined to be impaired (gross)			
- less than 30 days overdue	8	-	8
- 30 to 90 days overdue	116	-	116
- 90 to 180 days overdue	116	-	116
- 180 to 360 days overdue	99	-	99
- over 360 days overdue	725	-	725
Total collectively impaired	1,064	-	1,064
Receivables individually determined to be impaired (gross)			
- 30 to 90 days overdue	76	-	76
- 90 to 180 days overdue	455	-	455
Total individually impaired	531	-	531
Less: Provision for impairment	(1,422)	-	(1,422)
Total other financial and insurance assets	**504**	**4,170**	**4,674**

The analysis by credit quality of other financial and insurance receivables outstanding as at December 31, 2010 is as follows:

	Currency swap agreements	**Receivables from insurance policyholders**	**Amounts in the course of settlement and receivable for plastic cards transactions**	**Total**
Current and not impaired				
- A rated	502	-	-	502
- not rated	-	1,254	4,574	5,828
Total current and not impaired	502	1,254	4,574	6,330
Past due but not impaired				
- less than 30 days overdue	-	134	-	134
Total past due but not impaired	-	134	-	134
Receivables collectively determined to be impaired (gross)				
- less than 30 days overdue	-	54	-	54
- 30 to 90 days overdue	-	112	-	112
- 90 to 180 days overdue	-	108	-	108
- 180 to 360 days overdue	-	490	-	490
- over 360 days overdue	-	159	-	159
Total collectively impaired	-	923	-	923
Receivables individually determined to be impaired (gross)				
- 30 to 90 days overdue	-	134	-	134
- 90 to 180 days overdue	-	288	-	288
Total individually impaired	-	422	-	422
Less: Provision for impairment	-	(1,223)	-	(1,223)
Total other financial and insurance assets	**502**	**1,510**	**4,574**	**6,586**

In the above tables for an analysis of credit quality of other financial and insurance receivables, the management listed the classes in the order from highest to lowest credit quality as used for the purposes of internal monitoring and assessment.

During the year ended December 31, 2010, the Group entered into currency swap agreements with non-resident banks, whereby the Group sold EUR and GBP and bought USD at the transaction date and agreed to buy back the initially sold amount of EUR and GBP at a predetermined future date by paying USD at the predetermined foreign exchange rate. As at December 31, 2010, the Group had 2 outstanding currency swap agreements representing derivative financial instruments. The fair value of these derivative financial instruments was AZN 502 thousand as at December 31, 2010.

The carrying value of each class of other financial assets approximates fair value as at December 31, 2011 and December 31, 2010. As at December 31, 2011, the estimated fair value of other financial assets was AZN 4,674 thousand (December 31, 2010: AZN 6,586 thousand). Refer to Note 29.

11. OTHER ASSETS

	December 31, 2011	December 31, 2010
Advances for purchase of intangible assets and equipment	6,736	6,019
Prepaid expenses	2,532	2,238
Deferred acquisition costs on insurance premiums written	1,459	1,996
Deferred expenses for plastic cards	914	1,227
Taxes receivable, other than income tax	790	484
Prepaid insurance	442	287
Other	3,086	1,542
Total other assets	**15,959**	**13,793**
Current	9,268	8,257
Non-current	6,691	5,536
Total other assets	**15,959**	**13,793**

Included in the advances for purchase of intangible assets and equipment as at December 31, 2011 and 2010 are prepayments for office furniture and other assets for new Head Office building in the centre of Baku.

12. DUE TO OTHER BANKS

	December 31, 2011	December 31, 2010
Short-term placements of other banks	602,411	542,326
Correspondent accounts and overnight placements of other banks	252,670	399,183
Overdraft with CBAR	82,170	80,966
Total due to other banks	**937,251**	**1,022,475**

Included in due to other banks as at December 31, 2011 are four short-term placements amounting to EUR 323,000 thousand or AZN 328,749 thousand and correspondent account amounting to EUR 239,088 thousand or AZN 243,344 thousand, USD 930 thousand or AZN 731 thousand and XAU 697 or AZN 839 thousand of non-resident banks. These short-term placements bear market interest rates with maturities in March 2012 (December 31, 2010: two short-term placements amounting to EUR 180,000 thousand or AZN 190,080 thousand and correspondent account amounting to EUR 368,914 thousand or AZN 389,573 thousand and USD 930 thousand or AZN 742 thousand of a non-resident bank. These short-term placements bear market interest rates and matured in January 2011).

The carrying value of each class of due to other banks approximates fair value as at December 31, 2011 and December 31, 2010. As at December 31, 2011, the estimated fair value of due to other banks was AZN 937,251 thousand (December 31, 2010: AZN 1,022,475 thousand). Refer to Note 29.

Geographical, currency, liquidity and interest rate analyses of due to other banks is disclosed in Note 26. The information on related party balances is disclosed in Note 30.

13. CUSTOMER ACCOUNTS

	December 31, 2011	December 31, 2010
State and public organisations		
- Current/settlement accounts	557,918	276,541
- Term deposits	312,287	347,338
- Restricted customer deposits	256,657	348,410
	1,126,862	972,289
Other legal entities		
- Current/settlement accounts	377,134	240,389
- Term deposits	132,378	116,695
- Restricted customer deposits	55,106	2,118
	564,618	359,202
Individuals		
- Current/demand accounts	237,386	178,384
- Term deposits	828,414	601,740
	1,065,800	780,124
Total customer accounts	**2,757,280**	**2,111,615**

As at December 31, 2011, the Group had significant concentration of customer accounts attracted from one customer – a state organisation in the oil industry totalling AZN 702,912 thousand, and from one government body of AZN 250,902 thousand, or 34.6% of total customer accounts in aggregate (December 31, 2010: one customer – a state organisation in oil industry totalling AZN 497,095 thousand, and from one government body of AZN 331,399 thousand, or 39.2% of total customer accounts in aggregate).

Included in term deposits of state and public organizations are deposits of a state organization involved in the oil industry sector of the Republic of Azerbaijan totaling AZN 301,003 thousand. The interest rates on these deposits are 2.85% and 70% of overnight interest rate as per Reuters agency which is 0.18% as of December 31, 2011 (December 31, 2010: deposits of a state organization involved in the oil industry sector of the Republic of Azerbaijan totaling AZN 336,495 thousand. The interest rate on these deposits is 1.85% + LIBOR per annum).

Included in the current and settlement accounts of state and public organisations as at December 31, 2011 are balances on current interest bearing accounts of state-owned enterprises and government bodies of AZN 56,444 thousand (December 31, 2010: AZN 38,533 thousand). Interest rates on these accounts vary from 0.5% to 1.0% per annum (December 31, 2010: 0.5% to 1.0% per annum).

Restricted customer deposits amounting to AZN 311,763 thousand as at December 31, 2011 (December 31, 2010: AZN 350,528 thousand) represent balances on customer accounts held by the Group as collateral for irrevocable commitments under import letters of credit issued by the Group on behalf of its customers. The information on letters of credit and guarantees outstanding as at December 31, 2011 and 2010 is disclosed in Note 28.

Economic sector concentrations within customer accounts are as follows:

	December 31, 2011		December 31, 2010	
	Amount	%	Amount	%
Individuals	1,065,800	38.7	780,124	36.9
Energy	769,801	27.9	511,498	24.2
State and public organisations*	356,176	12.9	414,658	19.7
Trade and services	286,249	10.4	231,650	11.0
Construction	138,232	5.0	38,772	1.8
Manufacturing	89,333	3.2	27,364	1.3
Transportation and communication	38,642	1.4	89,436	4.2
Other	13,047	0.5	18,113	0.9
Total customer accounts	**2,757,280**	**100.0**	**2,111,615**	**100.0**

(*) State and public organisations comprise ministries, Treasury, municipalities and other state bodies of the Republic of Azerbaijan, excluding profit making state and public organisations that are included in the respective categories.

The carrying value of each class of customer accounts approximates fair value as at December 31, 2011 and 2010. As at December 31, 2011, the estimated fair value of customer accounts was AZN 2,757,280 thousand (December 31, 2010: AZN 2,111,615 thousand). Refer to Note 29.

Geographical, currency, liquidity and interest rate analyses of customer accounts is disclosed in Note 26. The information on related party balances is disclosed in Note 30.

14. DEBT SECURITIES IN ISSUE

	December 31, 2011	December 31, 2010
Deposit certificates	7,370	7,041
Total debt securities in issue	**7,370**	**7,041**

As at December 31, 2011, deposit certificates denominated in USD in the amount of AZN 6,663 thousand bear interest rates ranging between 8.0%-25.0% per annum and have maturities of one, two, three and ten years and deposit certificates denominated in AZN in the amount of AZN 707 thousand bear an interest rate of 25.0% per annum and have maturities of ten years (December 31, 2010: USD denominated amounting to AZN 6,340 thousand bear interest rates ranging between 10.0%-25.0% per annum and have maturities of three and ten years and deposit certificates denominated in AZN in the amount of AZN 701 thousand bear an interest rate of 25.0% per annum and have maturities of ten years). These certificates of deposit state as a condition that interest is paid each year only if certificates are held for the full period of that calendar year.

The carrying value of each class of debt securities in issue approximates fair value as at December 31, 2011 and 2010. As at December 31, 2011, the estimated fair value of debt securities in issue was AZN 7,370 thousand (December 31, 2010: AZN 7,041 thousand). Refer to Note 29.

Geographical, currency, liquidity and interest rate analyses of debt securities in issue is disclosed in Note 26.

15. OTHER BORROWED FUNDS

	December 31, 2011	December 31, 2010
Syndicated loan maturing on October 27, 2011	-	98,884
Syndicated loan maturing on July 23, 2013	76,637	79,790
Term borrowings from government organisations:		
- National Fund for Support of Entrepreneurship (the Republic of Azerbaijan)	41,501	28,761
Term borrowings from other financial institutions	623,539	603,489
Accrued interest payable	14,193	14,733
Total other borrowed funds	**755,870**	**825,657**

Syndicated borrowings

On July 23, 2010, Bank signed a facility agreement with foreign banks led by one of the major foreign banks in the amount of USD 100,000 thousand. The borrowing facilities are repayable on July 23, 2013.

On October 27, 2010, Bank signed a dual currency term loan facility agreement with foreign banks led by one of the major foreign banks in the amount of USD 51,000 thousand and EUR 56,000 thousand. The borrowing facilities were repaid on October 27, 2011.

Term borrowings from government organizations

As at December 31, 2011 included in term borrowings from government organizations are loans from the National Fund for Support of Entrepreneurship amounting AZN 41,501 thousand. These borrowings have annual rate of 1% and maturity period from 1 year to 7 years (December 31, 2010 : borrowings from National Fund for Support of Entrepreneurship amounting AZN 28,761 thousand, which has been borrowed with annual rate of 1% and maturity periods of 1 to 5 years).

Term borrowings from other financial institutions

Included in term borrowings from other financial institutions are funds attracted from twenty eight foreign banks and financial institutions. The amounts drawn down under credit agreements signed with these banks amounted to USD 549,153 thousand or AZN 431,909 thousand, EUR 183,006 thousand or AZN 186,264 thousand (December 31, 2010: funds attracted from twenty seven foreign banks and financial institutions with amount of USD 510,698 thousand or AZN 407,486 thousand and EUR 185,609 thousand or AZN 196,003 thousand).

The Bank is obliged to comply with certain financial covenants stipulated by some aforementioned borrowing agreements within syndicated borrowings and term borrowings from other financial institutions. Management believes that the Bank was in compliance with all financial covenants stipulated in borrowing agreements, except for those detailed in Note 28.

Market interest rates for the borrowings range between 1.0% to 8.9% per annum for the year ended December 31, 2011 (ranging between 0.9% to 12.2% per annum for the year ended December 31, 2010). All borrowings that belong to other borrowed funds category bear market interest rates.

The carrying value of each class of other borrowed funds approximates fair value as at December 31, 2011 and 2010. As at December 31, 2011, the estimated fair value of other borrowed funds was AZN 755,870 thousand (December 31, 2010: AZN 825,657 thousand). Refer to Note 29.

Geographical, currency, liquidity and interest rate analyses of other borrowed funds is disclosed in Note 26. The information on related party balances is disclosed in Note 30.

16. OTHER FINANCIAL AND INSURANCE LIABILITIES

Other financial and insurance liabilities comprise the following:

	December 31, 2011	December 31, 2010
Items in course of settlement	37,134	47,211
Insurance reserves, net	8,191	8,952
Sundry creditors	4,979	2,176
Payables on currency SWAP agreements	1,414	-
Insurance premiums and broker commissions payable	1,101	2,465
Payables to employees	206	289
Total other financial and insurance liabilities	**53,025**	**61,093**

During the year ended December 31, 2011, the Group entered into currency swap agreements with non-resident banks, whereby the Group sold EUR and GBP and bought USD at the transaction date and agreed to buy back the initially sold amount of EUR and GBP at a predetermined future date by paying USD at the predetermined foreign exchange rate. As at December 31, 2011, the Group had six outstanding currency swap agreements representing derivative financial instruments. The fair value of these derivative financial instruments was AZN 1,414 thousand as at December 31, 2011.

Movements in insurance reserves during the years ended December 31, 2011 and 2010 were as follows:

	December 31, 2009	Increase/(decrease) during the year	December 31, 2010	Increase/(decrease) during the year	December 31, 2011
IBNR					
Gross	1,388	(1,041)	347	271	618
Reinsurer's share	(300)	300	-	(110)	(110)
Net	1,088	(741)	347	161	508
UPR					
Gross	11,640	(2,566)	9,074	(312)	8,762
Reinsurer's share	(1,955)	319	(1,636)	(228)	(1,864)
Net	9,685	(2,247)	7,438	(540)	6,898
RBNS					
Gross	212	955	1,167	(382)	785
Net	212	955	1,167	(382)	785
Total	**10,985**	**(2,033)**	**8,952**	**(761)**	**8,191**

The carrying value of each class of other financial liabilities approximates fair value as at December 31, 2011 and 2010. Refer to Note 29.

17. OTHER LIABILITIES

Other liabilities comprise the following:

	December 31, 2011	December 31, 2010
Deferred revenue on plastic cards operations	6,378	7,866
Deferred commissions on insurance operations	21	28
Other	668	1,954
Total other liabilities	**7,067**	**9,848**
Current	6,645	1,796
Non-current	422	8,052
Total other liabilities	**7,067**	**9,848**

Deferred revenue on plastic cards operations represents the unearned portion of revenue related to fees charged for the annual maintenance of plastic card accounts. This fee is charged upon the issuance of cards and amortised over their respective term.

18. SUBORDINATED DEBT

	December 31, 2011	December 31, 2010
Credit Linked Notes issued by Rubrika Finance Company Limited	49,549	50,268
Subordinated debt from Asian Development Bank	-	15,958
Accrued interest payable	590	608
Total subordinated debt	**50,139**	**66,834**

On May 8, 2007, the Bank signed Subordinated Facility Agreement with Rubrika Finance Company Limited, legal entity registered in Dublin, for an issue of Credit Linked Notes on the Cayman Islands Stock Exchange to institutional investors from Europe and the United States of America for a total amount of USD 100,000 thousand for general corporate lending purposes. The debt bears annual fixed interest rate of 8.40%.The Credit Linked Notes mature on May 10, 2017. The Bank is obliged to comply with certain financial covenants stipulated by the aforementioned borrowing agreement. The Bank breached some of these covenants as at December 31, 2011. As "Event of Default" clause of the loan agreement does not refer to breach of covenants, management has not classified the outstanding amount of the subordinated debt as on demand. Management believes that subordinated debt will not be required to be repaid prior to the contractual maturity date as set out in the agreement.

On December 14, 2007, the Bank signed a subordinated debt agreement with the Asian Development Bank, registered in Manila, the Philippines, for obtaining funds in the amount not exceeding USD 20,000 thousand to be used in further lending activities of the Bank. The debt bears variable interest rate of LIBOR + 3.85% for first sixty months after the disbursement date and LIBOR + 5.35% for the rest of the period. The borrowing was repaid on June 25, 2011.

Interest rates on subordinated debts are at market rates. Market interest rate for these subordinated debts is 8.40% per annum. The repayment of Bank's subordinated debt ranks after all other creditors in case of liquidation of the Bank.

As at December 31, 2011, the estimated fair value of subordinated debt was AZN 50,139 thousand (December 31, 2010: AZN 68,834 thousand). Refer to Note 29.

Geographical, currency, liquidity and interest rate analyses of subordinated debt is disclosed in Note 26.

19. SHARE CAPITAL

The authorised, issued and paid-in capital of the Bank as at December 31, 2011 and December 31, 2010 is as follows:

	Number of paid-in and outstanding shares (in thousands)	Ordinary shares	Total
As at December 31, 2009	1,000,000	240,000	240,000
New shares paid-in	-	-	-
As at December 31, 2010	1,000,000	240,000	240,000
New shares paid-in	-	-	-
As at December 31, 2011	1,000,000	240,000	240,000

All ordinary shares have a nominal value of AZN 0.24 per share as at December 31, 2011 and 2010 and rank equally. Each share carries one vote.

The weighted average number of ordinary shares outstanding during the year ended December 31, 2011 and 2010 was 1,000,000 thousand.

As at December 31, 2011 and 2010, the Ministry of Finance of the Republic of Azerbaijan ("MoF") paid all subscribed shares and held 50.2% of the total paid-in share capital of the Bank.

As at December 2011 and 2010 the shareholders paid all ordinary shares in issue.

As at December 31, 2011, the Group's employees held 5.63% of the total share capital of the Bank, or 56,303 thousand ordinary shares with a par value of AZN 13,513 thousand (December 31, 2010: 6.36% or 63,590 thousand ordinary shares with a par value of AZN 15,262 thousand).

20. INTEREST INCOME AND EXPENSE

	Year ended December 31, 2011	Year ended December 31, 2010
Interest income comprises:		
Interest income on financial assets recorded at amortized cost:		
- interest income on unimpaired financial assets	225,994	239,462
- interest income on impaired financial assets	84,307	88,987
Total interest income	310,301	328,449
Interest income on financial assets recorded at amortized cost comprises:		
Loans and advances to customers	278,213	275,845
Due from other banks and correspondent accounts	27,247	23,930
Interest income on contingencies	4,841	28,674
Total interest income	310,301	328,449
Interest expense comprises:		
Due to other banks and other borrowed funds	100,310	94,690
Savings deposits of individuals and deposit certificates	80,505	60,387
Term deposits of legal entities	8,907	8,650
Subordinated debt	4,274	5,030
Total interest expense	193,996	168,757
Net interest income	**116,305**	**159,692**

For information on related party transactions, see Note 30.

21. FEE AND COMMISSION INCOME AND EXPENSE

	Year ended December 31, 2011	Year ended December 31, 2010
Fee and commission income:		
- Plastic cards operations	36,444	32,098
- Transactions with foreign currencies	20,786	18,756
- Settlement transactions	10,846	13,142
- Cash transactions	6,570	10,431
- Guarantees issued	1,863	2,584
- Letters of credit issued	1,709	792
- Servicing intermediary loans	303	1,031
- Securities operations	-	1
- Other	2,538	1,918
Total fee and commission income	81,059	80,753
Fee and commission expense:		
- Settlement transactions	10,845	4,051
- Plastic cards operations	6,176	6,817
- Policy acquisition costs on insurance operations	2,521	2,273
- Cash transactions	1,803	1,091
- Guarantees	576	958
- Securities operations	-	99
- Other	549	353
Total fee and commission expense	22,470	15,642
Net fee and commission income	**58,589**	**65,111**

22. ADMINISTRATIVE AND OTHER OPERATING EXPENSES

	Year ended December 31, 2011	Year ended December 31, 2010
Staff costs	44,847	41,820
Depreciation of premises and equipment	11,391	10,965
Tax penalties	11,301	-
Customs duties and taxes other than on income	9,277	8,601
Charity and financial aid	7,988	8,181
Advertising and marketing services	6,487	12,596
Rent	5,685	5,067
Consultancy	4,068	4,868
External labour and guarding	3,429	3,069
Premises, equipment and investment property maintenance	3,314	2,651
Amortisation of software and other intangible assets	2,644	2,939
Communication	2,337	2,326
Stationary, books, printing, and other supplies	1,253	1,289
Fees paid to deposit insurance fund	1,239	1,574
Business trips	782	684
Software maintenance	760	655
Property insurance	676	15
Purchase of plastic cards	449	717
Training	392	354
Transportation of valuables	59	37
Cost of sales of POS terminals	-	1,086
Other	3,776	6,528
Total administrative and other operating expenses	**122,154**	**116,022**

Included in staff costs are obligatory payments to the State Social Protection Fund of the Republic of Azerbaijan of AZN 7,146 thousand (2010: AZN 5,849 thousand). In addition, AZN 731 thousand was collected by the Group as a deduction from employee salaries and paid to the State Social Protection Fund on their behalf (2010: AZN 725 thousand).

Included in charity and financial aid expenses incurred during the year are AZN 7,200 thousand paid to "Inter" professional football club (2010: AZN 2,210 thousand paid to "Inter" professional football club).

Rental expenses are related to the lease of the Group's branch buildings in Baku and in the regions of the Republic of Azerbaijan, exchange offices and rental costs associated with ATMs installed, for example, in department stores and hotels.

For information on related party transactions, see Note 30.

23. INCOME TAXES

Income tax (expense)/benefit comprises the following:

	Year ended December 31, 2011	**Year ended December 31, 2010**
Current tax	(4,506)	(19,079)
Deferred tax	(10,566)	41,960
Income tax (expense)/benefit for the year	**(15,072)**	**22,881**

The income tax rate applicable to the majority of the Group's income is 20% as at December 31, 2011 and 2010. The income tax rate applicable to the operations of IBA Moscow is 20% as at December 31, 2011 and 2010.

Reconciliation between the expected and the actual taxation charge is provided below.

	Year ended December 31, 2011	**Year ended December 31, 2010**
IFRS profit/(loss) before income tax	**34,633**	**(133,486)**
Theoretical tax charge at statutory rate (20%)	(6,927)	26,697
Tax effect of items which are not deductible or assessable for taxation purposes:		
-Non deductible expenses	(8,145)	(3,811)
-Under-provision of income tax in prior years	-	(184)
-Change in deferred tax not recognized	-	179
Income tax (expense)/benefit for the year	**(15,072)**	**22,881**

Differences between IFRS and Azerbaijani and Russian (for IBA Moscow) statutory taxation regulations give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below and is recorded at the rate of 20%:

	December 31, 2010	(Charged)/ credited to profit or loss	Credited directly to other comprehensive income	December 31, 2011
Tax effect of deductible/(taxable) temporary differences				
Losses on assets and liabilities at non-market rates	2,555	32	-	2,587
Deferred revenue recognition	1,113	-	-	1,113
Provision for letters of credit and guarantees	(3,820)	(573)	-	(4,393)
Accruals and other	54	-	-	54
Provision for loan impairment	54,693	(58,897)	-	(4,204)
Premises, equipment and intangible assets	(8,708)	320	(447)	(8,835)
Revenue accruals	1,899	-	-	1,899
Tax effect of share of loss of associates	100	(63)	-	37
Tax effect of fair value gain of derivatives	711	-	-	711
Tax loss carryforwards	104	48,835	-	48,939
Other	(1,055)	(220)	-	(1,275)
	47,646	(10,566)	(447)	36,633
Deferred tax not recognized	(50)	-	-	(50)
Recognised deferred tax asset	**47,596**	**(10,566)**	**(447)**	**36,583**

In the context of the Group's current structure and applicable tax legislation, tax losses and current tax assets of different group companies may not be offset against current tax liabilities and taxable profits of other group companies and, accordingly, taxes may accrue even where there is a consolidated tax loss. Therefore, deferred tax assets and liabilities are offset only when they relate to the same taxable entity and the same taxation authority.

	December 31, 2009	(Charged)/ credited to profit or loss	December 31, 2010
Tax effect of deductible/(taxable) temporary differences			
Losses on assets and liabilities at non-market rates	155	2,400	2,555
Deferred revenue recognition	482	631	1,113
Provision for letters of credit and guarantees	168	(3,988)	(3,820)
Accruals and other	17	37	54
Provision for loan impairment	13,465	41,228	54,693
Premises, equipment and intangible assets	(9,310)	602	(8,708)
Revenue accruals	1,496	403	1,899
Tax effect of share of loss of associates	(136)	236	100
Tax effect of fair value gain of derivatives	(222)	933	711
Tax loss carryforwards	-	104	104
Other	(479)	(576)	(1,055)
	5,636	42,010	47,646
Deferred tax not recognized	-	(50)	(50)
Recognised deferred tax asset	**5,636**	**41,960**	**47,596**

The composition of the total net deferred tax asset/(liability) of the Group after offsetting within the individual entities comprising the Group is, as follows:

	December 31, 2011	December 31, 2010
Total net deferred tax asset	38,728	49,412
Total net deferred tax liability	(2,145)	(1,816)
Total net deferred tax asset of the Group	**36,583**	**47,596**

24. EARNINGS/(LOSS) PER SHARE

Basic earnings/(loss) per share are calculated by dividing the profit or loss attributable to owners of the Bank by the weighted average number of ordinary shares in issue during the year, excluding treasury shares. There were no treasury shares outstanding as at December 31, 2011 and 2010.

The Group has no dilutive potential ordinary shares; therefore, the diluted earnings/(loss) per share equal the basic earnings/(loss) per share.

	Year ended December 31, 2011	Year ended December 31, 2010
Profit/(loss) for the year attributable to ordinary shareholders	19,501	(110,301)
Weighted average number of ordinary shares in issue (thousands)	1,000,000	1,000,000
Basic and diluted earnings/(loss) per ordinary share (expressed in AZN per share)	**0.02**	**(0.11)**

25. SEGMENT ANALYSIS

The chief operating decision maker, the Chairman of the Board of Directors, reviews the Group's internal reporting in order to assess performance and allocate resources. The operating segments have been determined based on these reports as follows:

- Banking – representing private and corporate banking services, private and corporate customer current accounts, savings, deposits, investment savings products, custody, credit and debit cards, consumer loans and mortgages, direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities, foreign currency and derivative products for retail and corporate customers.
- Insurance – representing the activities carried out by the Group's insurance subsidiary.
- Card processing – representing the activities carried out by the Group's card processing subsidiary.

The Chairman of the Board of Directors assesses the performance of the operating segments based on a measure of adjusted profit before income tax. This measurement basis excludes the effects of non-recurring expenditure from the operating segments, such as impairment of premises. Other information provided to the Chairman of the Board of Directors is measured in a manner consistent with that in these consolidated financial statements, except that segment assets reported to the Chairman of the Board of Directors exclude deferred income tax asset which is managed on a central basis. These are part of the reconciliation to total consolidated statement of financial position assets. In addition to that, the Group does not allocate depreciation and amortisation expenses, as well as share of profit or loss of the associates among its segments. These are the part of the reconciliation to items of the consolidated statement of the comprehensive income.

Segment information for the reportable segments of the Group for the years ended December 31, 2011 and 2010 is set out below:

	Banking	Insurance	Card processing	Total Group
Year ended December 31, 2011				
External revenues:				
- Interest income	324,770	818	1,133	326,721
- Fee and commission income	74,043	45	14,195	88,283
- Other operating income	29,707	13,228	761	43,696
Total revenue	428,520	14,091	16,089	458,700
Inter-segment revenue	(16,249)	(1,002)	(7,393)	(24,644)
Revenue from external customers	412,271	13,089	8,696	434,056
External expenses:				
- Interest expense	210,416	-	-	210,416
- Fee and commission expense	27,089	-	2,563	29,652
- Other operating expense	757	-	285	1,042
Total expense	238,262	-	2,848	241,110
Inter-segment expense	(24,359)	-	(285)	(24,644)
Expense from external customers	213,903	-	2,563	216,466
Adjusted profit before income tax	39,255	2,015	8,188	49,458
Year ended December 31, 2010				
External revenues:				
- Interest income	327,846	1,016	382	329,244
- Fee and commission income	77,242	51	9,116	86,409
- Other operating income	28,278	11,824	-	40,102
Total revenue	433,366	12,891	9,498	455,755
Inter-segment revenue	(1,435)	(1,029)	(5,016)	(7,480)
Revenue from external customers	431,931	11,862	4,482	448,275
External expenses:				
- Interest expense	169,994	-	-	169,994
- Fee and commission expense	18,510	2,313	-	20,823
- Other operating expense	812	-	84	896
Total expense	189,316	2,313	84	191,713
Inter-segment expense	(7,230)	-	(84)	(7,314)
Expense from external customers	182,086	2,313	-	184,399
Adjusted loss before income tax	(113,343)	(4,023)	(1,718)	(119,084)
Total assets reported				
December 31, 2011	4,813,704	14,406	15,516	4,843,626
December 31, 2010	4,331,145	13,994	13,175	4,358,314

Total consolidated revenues comprise interest income, fee and commission income and other operating income and are reconciled to the sum of these items on the face of the consolidated statement of comprehensive income. Total consolidated expenses comprise interest expense and fee and commission expense and are reconciled to the sum of these items on the face of the consolidated statement of comprehensive income.

A reconciliation of adjusted profit before income tax to total profit before income tax is provided as follows:

	Year ended December 31, 2011	Year ended December 31, 2010
Adjusted profit/(loss) before income tax for reportable segments	**49,458**	**(119,084)**
Depreciation	(11,391)	(10,965)
Amortisation	(2,644)	(2,939)
Share of post-tax loss of associates	(790)	(498)
Profit/(loss) before income tax	**34,633**	**(133,486)**

The adjustments are attributable to the following:

- The Group does not allocate depreciation and amortisation to the segments.
- The Group does not allocate share of loss of associates to segments.

Reportable segments' assets are reconciled to total assets as follows:

	December 31, 2011	December 31, 2010
Total segment assets	4,804,898	4,308,902
Deferred income tax assets	38,728	49,412
Total assets per consolidated statement of financial position	**4,843,626**	**4,358,314**

The Group applies an asymmetric approach regarding the allocation of non-current assets and related depreciation charges between segments, whereby the Group allocates non-current assets between segments whereas does not allocate related depreciation charges.

The adjustments are attributable to the following:

- Deferred income tax assets are not calculated for the purpose of internal management reporting.

Geographical information for non-current assets other than financial and insurance assets and taxes:

	December 31, 2011	December 31, 2010
The Republic of Azerbaijan	150,554	148,039
Russia	13,257	12,396
Georgia	5,126	4,966
Total non-current assets per consolidated statement of financial position	**168,937**	**165,401**

Revenues for each individual country for which the revenues are material are reported separately as follows:

	December 31, 2011	December 31, 2010
The Republic of Azerbaijan	370,664	384,884
Russia	58,687	60,636
Georgia	4,705	2,755
Total consolidated revenues	**434,056**	**448,275**

26. FINANCIAL RISK MANAGEMENT

The Group has exposure to financial risks which include credit, liquidity, market and operational risks. The taking of risk is integral to the Group's business. The Group's risk management function's aim is to achieve an appropriate balance between risk and return and to minimise potential adverse effects on the Group's financial performance.

The risk management framework

The risk management function is an integral part of the Group's internal control system and is centralised. The Group's risk management policies and approaches aim to identify, analyse, mitigate and manage the risks faced by the Group. This is accomplished through setting appropriate risk limits and controls, continuously monitoring risk levels and the adherence to limits and procedures and ensuring that business processes are correctly formulated and maintained.

Risk Management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered. The Group, as part of its risk culture, emphasises integrity, management and employee standards in order to maintain and continuously improve upon a conservative control environment.

Risk management bodies and governance

Risk management policy, assessment, approval, monitoring and controls are conducted by a number of specialised bodies within the Group. These bodies also oversee the risk management policies and controls at the Group's subsidiaries. The Group has established executive bodies, committees and departments, which conform to Azerbaijani law, the CBAR regulations and the best industry practices.

The Supervisory Board of the Group has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing and approving risk management policies as well as several key risk limit approval authorities, including significantly large exposures, economic and product sector limits. It also delegates certain authority levels to the Executive Board and the Credit Committee.

Established by, appointed by and reporting directly to the Supervisory Board are the Executive Board, the Risk Management Department, the Audit Committee ("AC"), the Internal Audit Department, the Credit Committee and the Asset and Liability Committee ("ALCO") and Committee of Information Technology.

The Executive Board is responsible for the implementation and monitoring of risk mitigation measures and ensuring that the Group operates within the established risk parameters. The Member of the Executive Board responsible for risk management along with the Risk Management Department, which reports to this Director, are responsible for the overall risk management functions, ensuring the implementation of common principles and methods for identifying, measuring, mitigating, managing and reporting both financial and non-financial risks.

The Risk Management Department is chaired by the Chairman of the Executive Board responsible for risk management. This Committee is responsible for establishing risk management methodologies and ensuring that the risk appetite of the Group is correctly reflected in the strategic and business plans of the Group. It is the main forum for discussing and recommending changes in all risk approaches and procedures to the Executive and Supervisory Boards. It ensures that the Risk Management Department, the Credit Committee and ALCO, as well as the Executive Board, address all potential risks facing the Group prepared by the Management and reviewed by the Audit Committee and reports on these issues to the Supervisory Board.

ALCO is responsible for the management and optimisation of the Group's asset and liability structure. It is an integral part of the risk management process that focuses on various market risks, including liquidity, foreign currency and interest rate risks. ALCO's functions include making recommendations for approval of strategies, policies and limits associated with the aforementioned risks. It is responsible for providing timely and reliable information and reports regarding these risk areas. ALCO assists in setting pricing policies and funding strategies. It is also responsible, along with other risk management and controlling units of the Group, for ensuring that Treasury and other relevant units work with the parameters set by ALCO, the Risk Management Department, the Executive Board and the Supervisory Board.

The information Technology Committee is chaired by the First Deputy Chairman of the Executive Board and responsible for determination of strategy of use of IT and communication technologies. It ensures that structures of the Bank uses modern technologies for providing high level services to its clients. The Information Technology Committee defines IT procedures. All major IT issues are presented to the Supervisory Board for discussion with prior consent of the Executive Board.

The Audit Committee

The Audit Committee ("AC") is responsible for overseeing and monitoring the internal control framework of the Group and for assessing the adequacy of risk management policies and procedures, as an integral part of the internal control system of the Group. The AC members cannot be employees or part of the management structure of the Group. They provide recommendations to the Executive Board, the Risk Management Department and the Supervisory Board on development of the framework, as well as their views on, the quality of risk management and compliance with established policies, procedures and limits. The AC supervises the work of the Internal Audit, which reports directly to the AC. The Internal Audit's working plans, schedule of audits and its reports, including non-planned audits, are closely reviewed and approved by the AC. Implementation plans based on the AC's recommendations, including status reports, are approved by the Executive Board and reported to the Executive Board, the Supervisory Board and the General Meeting of the Shareholders.

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty fails to meet its contractual obligations when due. The major portion of credit risk arises from the Groups' loans and advances to customers and banks and other on and off balance sheet credit exposures. For risk reporting purposes, the Group considers and consolidates all elements of credit risk exposures such as individual customer and counterparty default risk and industry risk.

The general credit risk approval structure, for corporate legal entities, private individuals and financial organisations, is as follows:

Supervisory Board	The Supervisory Board reviews and approves limits above AZN 1.5 million and meets on a regular basis
Executive Board	The Executive Board reviews and approves limits above 1% of total regulatory capital up to a maximum limit of AZN 1.5 million and meets on a regular basis
Credit Committee	The Credit Committee reviews and approves limits up to 1% of total regulatory capital and meets on a regular basis

The Supervisory Board also approves general limits so as to control and manage risk diversification:

- Portfolio limits: Corporate loans, retail loans and interbank exposures as percentages of the total portfolio;
- Portfolio limits: Secured facilities and unsecured facilities as percentages of the total portfolios and as a percentage of the retail portfolio; and
- Economic sector and product exposures: as a percentage of the corporate and retail portfolios.

The Executive Board also approves limits and authority levels for exposures, as follows:

- By branch;
- By collateral type and loan to value ratios; and
- By individual authority.

As at December 31, 2011, the breakdown of the loan portfolio by economic and product sectors is provided in Note 7.

Credit risk management

Credit risk policy is developed by the Risk Management Department and Executive Board in line with the risk profile and strategic plans of the Group. It is approved by the Supervisory Board.

This policy establishes:

- Procedures for generating, analysing, reviewing and approving counterparty risk exposures;
- The methodology for the credit assessment of counterparties;
- The methodology for the credit rating of counterparties;
- The methodology for the evaluation and control of collateral;
- Credit documentation requirements;
- Loan administration procedures;
- Procedures for the ongoing monitoring of credit exposures; and
- Loan loss provisioning policy.

Loan/credit requests are originated and generated by client managers and credit inspectors. Credit applications within approved authority limits are approved by the branches or relevant business generating units. Then copies of these approved requests are submitted to the Risk Management Department for post-control, including being assigned a rating and input into a monitoring schedule. Risk exposure requests above these limits are sent to the Credit Committee. The Credit Committee performs a secondary analysis and issues a report, rating and opinion. If the credit request is below a certain authorised limit and receives a positive opinion from the Credit Committee, and is signed off by the appropriate individuals, then the request is considered approved. If the opinion of risk management is negative then the request is sent to the Credit Committee for adjudication. If approved and the transaction is in an amount higher than the competence of the Credit Committee then it is sent to the Executive Board for approval. Large transactions, as defined above, have to be submitted to the Supervisory Board for approval.

The Group uses a rating system based on an analysis of four basic criteria: creditworthiness, financial performance, credit history and other risks. The Group uses this system for decision-making purposes to lend to new borrowers. For the quality of its existing loan portfolio, the Group uses the classification as disclosed in Note 7 to these consolidated financial statements.

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

For certain retail loan products, a credit scoring system is used, plus the Group uses its internal database and that of the CBAR to identify potentially risky customers. Credit assessments are done on a portfolio basis concentrating on amount and term limits, approval procedures, target groups, types of product, default statistics, loan/value ratios (if applicable), and pricing.

Collateral and other credit enhancements

Exposure to credit risk is also assessed and managed, in part, by obtaining, controlling and monitoring collateral in the form of mortgage interests over property, pledge of assets and securities and other collateral including deposits, corporate and personal guarantees.

While collateral is an important mitigating factor in assessing the credit risk, it is the Group's policy to establish that loans are within the customer's capacity to repay rather than to rely solely on security. Collateral is considered as a secondary source of repayment. In limited cases, depending on the customer's standing or on the type of product or amounts, the facilities may be unsecured. The Group has in place various limits on the unsecured portions of its risk portfolio.

The principal types of collateral accepted by the Group are as follows:

- Commercial real estate
- Residential real estate
- Corporate capital assets
- Transport vehicles
- Term deposits
- Other including precious metals

Strict appraisal, documentation and, where applicable, registration procedures are in place for all forms of collaterals. Loan to value ratios are approved by the Executive Board and controlled by the Risk Management Department. The loan to value limits as of December 31, 2011 are as follows:

Type of collateral	**Ratio of loan amount to liquid value of collateral**
Real estate	up to 60%
Precious metals	up to 80%
Machinery, equipment	up to 50%
Inventory	up to 60%
Vehicles, transport	up to 70%
Term deposit	up to 90%

However, management notes that the above limits may at certain times be overridden based on commercial considerations.

The Risk Management Department is responsible for establishing a schedule of monitoring events, fulfilling this plan and notifying the appropriate parties if the monitoring results are unsatisfactory and recommending a plan of action. The Risk Management Department physically monitors all transactions above an established amount plus does selected checks of transactions below this amount. All transactions above a certain amount are first monitored either before or at least within one month of disbursement. Following this, risk exposures are monitored according to a schedule.

The Risk Management Department is charged with compiling and reporting on all counterparty credit risk issues, including compliance with all limits, risk concentrations, portfolio trends, past due and default statistics, loan loss reserves and collateral statistics. Besides regular monthly reporting, they also compile reports on adherence to selected credit procedures.

Related party lending

The CBAR has strict definitions regarding the category of "related parties". Mainly, these are corporate entities owned/controlled by the Shareholders or the private individual shareholders themselves or immediate family members. Also included are individuals with senior management/authority positions in the Group. The largest loan per related party private individual may not be more than 3% of the consolidated capital of the Group. Per related corporate entity, the limit is 10%. The overall limit for related party risk exposure is 20%. Pricing and other terms and conditions must be done on an arms-length basis. The Bank may at times be in breach of certain statutory covenants set out by the CBAR on related party balances. For information on potential consequences of those breaches refer to Note 28.

Past due, non-performing loans

The Group has in place procedures for reporting and dealing with past-due and non-performing loans from the first day past-due. Up to 60-day past-dues are all handled by the relevant business units unless obvious problems are identified earlier. Unsecured retail loans over 60-days past-due are automatically transferred to the Problematic Loans Department. Corporate loans over 90-days past-due are also transferred to this department. All loans are placed on non-accrual after 90 days past due for the purposes of the statutory financial statements as per requirement by the Central Bank. If the Problematic Loans Department is unsuccessful in collecting these obligations, then legal proceedings are instituted. When a loan is deemed uncollectible, recommendations to write-off these amounts are presented to the Credit Committee and the Executive Board. Final decisions regarding write-offs are taken by the Supervisory Board.

All past-dues statistics are reported to the Credit Committee on at least a monthly basis. All corporate loan past-due issues are individually reported to the Credit Committee.

Provision for loan impairment – reserve policy

The Group establishes an allowance for loan losses that represents its estimate of losses incurred in its risk exposures.

The CBAR also has a reserving policy, which is a minimum standard for banks. The categories with reserve requirements are as follows:

Standard assets	2%
Controllable assets	10%
Unsatisfactory assets	30%
Assets-at-risk	60%
Hopeless assets	100%

These categories are strictly defined.

In its IFRS reporting, the Group utilises the methodology contained in IAS 39 – Financial Instruments: Recognition and Measurement.

Maximum exposure to credit risk

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

The maximum credit risk for off-balance items, mainly loan commitments, letters of credit and guarantees, represents the gross amount of the commitment. The Group's maximum exposure to off-balance sheet credit risk is disclosed in Note 28, "Contingencies and Commitments".

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

Management of insurance risks

Insurance risk

The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and, therefore, unpredictable for each individual insurance contract.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Group faces under its insurance contracts is that the actual claims and benefit payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits may be greater than estimated. Insured events are random and the actual number and amount of claims and benefits will vary from year to year from the level established using statistical techniques.

The Group manages its insurance risk by means of established internal procedures which include underwriting authority levels, pricing policy, approved reinsurers list and ongoing monitoring.

Estimation of insurance loss reserves

Loss provisions are calculated based on the Group's historical data. In calculating the estimated cost of unpaid claims (both reported and not), the Group's estimation techniques include a combination of loss ratio-based estimates (where the loss ratio is defined as the ratio between the ultimate cost of insurance claims and insurance premiums earned in a particular financial year in relation to such claims) and an estimate based upon actual claims experience using predetermined formulae where a greater weight is given to actual claims experience as time passes.

The initial loss ratio estimate is an important assumption in the estimation technique and is based on previous years' experience, adjusted for factors such as premium rate changes, anticipated market experience and historical claims inflation. The initial estimate of the loss ratios used for the current year (before reinsurance) are analysed by type of risk for current and prior year premiums earned.

Sources of uncertainty in the estimation of future claim payments

Claims on insurance contracts are payable on a claims-occurrence basis. The Group is liable for all insured events that occurred during the term of the contract. As a result, liability claims are settled within a short period of time, which historically has not exceeded 3 months from the end of the contract term. There are several variables that affect the amount and timing of cash flows from insurance contracts. These mainly relate to the inherent risks of the activities carried out by both corporate and individual contract holders and the risk management procedures they adopted. The compensation paid on insurance contracts in the Group's portfolio primarily consists of monetary awards granted for:

- medical insurance;
- physical damage to motor vehicles (for motor vehicle insurance covers); and
- financial loss, bodily injury and physical damage suffered by the third parties (caused by the vehicle owners).

Such awards are lump-sum payments that are calculated by the Group's in-house underwriters as the present value of the lost earnings and rehabilitation expenses that the injured party will incur as a result of the accident.

Reinsurance policy

An element of the Group's motor, property, third party liability, employer liability and cargo portfolios is reinsured with local and foreign insurance companies under reinsurance agreements that reduce the potential maximum exposure that the Group is subject to.

Diversification

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected by a change in any subset of the portfolio. The Group has developed its insurance underwriting strategy to diversify the type of insurance risks accepted and within each of these categories to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

Market risk

The Group is exposed to market risks. Market risks arise from open positions in interest rates, currency and equity products, all of which are exposed to general and specific market movements. The Group manages market risk through policies of very limited exposures to these risks and periodic estimations of the Group's positions regarding these risks.

The Group does not have any trading positions in financial instruments. Its exposure to the securities market is the investment, from time to time, in the CBAR notes, Azerbaijan Ministry of Finance obligations and securities issued by other banks in order to help manage its consolidated liquidity position. The Group does not normally trade in the derivatives market, except for trading in currency swap agreements.

Currency risk

The Group is exposed to effects of fluctuation in the prevailing local/foreign currency exchange rates on its consolidated financial position. Currency risk is the risk that movements in foreign exchange rates will affect the Group's income or the value of its portfolios of financial instruments.

The main element in the Group's risk policy regarding foreign currency risk is that there is no conscious effort to take a trading position in any currency. Limited open positions occur as a natural consequence of business operations only. The Group uses every effort to match its assets and liabilities by currency.

Exposure to foreign exchange risk faced by the Bank is also limited by the CBAR normative requirements, which place a 10% of capital limit on open positions in any single foreign currency and a 20% open limit on all foreign currencies.

The foreign exchange exposures are managed by the Accounting and Control Department. The reports on open currency positions prepared by the Accounting and Control Department are reviewed by ALCO.

The table below summarises the Group's consolidated exposure to foreign currency exchange rate risk at the end of the reporting period:

	December 31, 2011				December 31, 2010			
	Monetary financial and insurance assets	**Monetary financial and insurance liabilities**	**Foreign currency swap agreements**	**Net position**	**Monetary financial and insurance assets**	**Monetary financial and insurance liabilities**	**Foreign currency swap agreements**	**Net position**
AZN	1,601,215	1,090,152	-	511,063	1,192,122	820,547	-	371,575
USD	2,151,016	2,226,926	(211,036)	(286,946)	1,942,995	2,061,696	(54,773)	(173,474)
EUR	646,357	1,072,306	203,560	(222,389)	889,733	1,139,567	52,800	(197,034)
RR	155,814	107,675	-	48,139	96,419	52,324	-	44,095
Other	65,317	55,564	6,062	15,815	10,436	13,143	2,475	(232)
Total	**4,619,719**	**4,552,623**	**(1,414)**	**65,682**	**4,131,705**	**4,087,277**	**502**	**44,930**

In the above table, monetary financial and insurance assets and liabilities columns exclude the financial assets and liabilities arising from foreign currency swap agreements, which are disclosed in separate column.

Foreign currency swap agreements in the amount of EUR and GBP receivables of AZN 209,622 thousand and USD payable of AZN 211,036 thousand resulted in net fair value loss on derivatives in the amount of AZN 1,414 thousand (December 31, 2010: EUR and GBP receivable of AZN 55,275 thousand and USD payable of AZN 54,773 thousand resulted in net fair value gain on derivatives in the amount of AZN 502 thousand). Refer to Note 10 and 16. All foreign currency swap agreements are short-term which mature in January 2012. The above analysis includes only monetary assets and liabilities. Investments in equities and non-monetary assets are not considered to give rise to any material currency risk.

The Group has extended loans and advances denominated in foreign currencies. Depending on the revenue stream and cost structure of the borrower, the possible appreciation of the currencies, in which loans and advances have been extended against the Azerbaijani Manat may, adversely affect the borrower's repayment ability and, therefore, increase the potential of future loan losses.

Currency risk sensitivity

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

Effect on profit or loss and equity:

	USD impact		**EUR impact**		**RR impact**	
	2011	**2010**	**2011**	**2010**	**2011**	**2010**
Strengthening by 10%	28,695	17,347	22,239	19,703	(4,814)	(4,410)
Weakening by 10%	(28,695)	(17,347)	(22,239)	(19,703)	4,814	4,410

In management's opinion, the sensitivity analysis is unrepresentative of the inherent foreign exchange risk because the year end exposure does not reflect the exposure during the year.

Interest rate risk

The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its consolidated financial position and consolidated cash flows. Interest margins may increase as a result of such changes, but may reduce or create losses in the event that unexpected movements arise. Management monitors on a daily basis and sets limits on the level of mismatch of interest rate repricing that may be undertaken.

At present, the Group manages its interest rate risk by matching, where possible, its maturity and/or repricing positions. In addition, the Group's monthly interest margins are continually reviewed in order to reprice its assets when deemed appropriate. Operational procedures set the acceptable interest rate margin usually at a minimum 5%. ALCO and the Accounting and Control Department constantly monitor the maintenance of this margin. ALCO is also responsible for preparing interest rate movement reports and forecasts. At present, through the Group's matching policies for expected repricing and relatively high interest rate margins achieved in the Group's markets, the Group does not more actively manage this risk.

ALCO and the Accounting and Control Department are responsible for managing interest rate risk, the Risk Management Department is responsible for controlling the risk and the Executive Board must approve all guidelines and asset/liability repricing reports.

The sensitivity analyses below have been determined based on the exposure to interest rates at the end of the reporting period. For floating rate liabilities, the analysis is prepared assuming the amount of the liability outstanding at the end of the reporting period was outstanding for the whole year. A 50 basis point increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

If interest rates had been 50 basis points higher/lower and all other variables were held constant, the Group's profit and equity for the year ended December 31, 2011 would decrease/increase by AZN 6,872 thousand (December 31, 2010: decrease/increase by AZN 6,425 thousand). This is mainly attributable to the Group's exposure to interest rates on its variable rate borrowings.

The Group monitors interest rates for its financial instruments. The table below summarises interest rates based on reports reviewed by key management personnel:

	2011					2010				
	USD	**AZN**	**Euro**	**RR**	**Other**	**USD**	**AZN**	**Euro**	**RR**	**Other**
Assets										
Cash and cash equivalents	-	-	0.3	-	-	0.4	0.3	-	-	0.3
Due from resident banks	3.1	5.0	-	-	-	7.4	1.0	-	-	-
Due from non resident banks	1.2	-	-	-	-	0.9	-	0.3	-	0.2
Loans and advances to customers – individuals	20.3	21.4	16.4	-	18	21.0	21.1	17.7	-	-
Loans and advances to customers – corporate	13.8	17.0	11.4	-	17.5	13.6	18.3	10.4	18.0	-
Liabilities										
Customer accounts – individuals	12.1	11.4	8.9	-	7.9	13.1	12.6	9.3	-	8.4
Customer accounts – corporate	9.0	14.6	13.9	-	-	5.1	9.6	7.0	-	-
Due to other banks	0.5	-	2.2	-	-	8.3	0.9	1.8	-	-
Debt securities in issue	15.0	25.0	-	-	-	10.0	25.0	-	-	-
Other borrowed funds	4.2	0.1	0.9	-	-	6.4	2.9	3.2	-	-
Subordinated debt	8.4	-	-	-	-	7.5	-	-	-	-

The sign "-" in the table above means that the Group does not have the respective assets or liabilities in the corresponding currency.

Geographical risk concentrations

The geographical concentration of the Group's consolidated financial assets and liabilities as at December 31, 2011 is set out below:

	The Republic of Azerbaijan	OECD countries	Other non-OECD countries	Total
FINANCIAL ASSETS:				
Cash and cash equivalents	143,804	199,996	47,581	391,381
Mandatory cash balances with the National/Central banks	94,423	-	9,484	103,907
Due from other banks	14,161	11,840	75,664	101,665
Loans and advances to customers	3,025,446	119,254	863,484	4,008,184
Financial assets at fair value through profit or loss	-	-	5,857	5,857
Available-for-sale investments	81	-	3,970	4,051
Other financial and insurance assets	4,291	-	383	4,674
TOTAL FINANCIAL ASSETS	**3,282,206**	**331,090**	**1,006,423**	**4,619,719**
FINANCIAL LIABILITIES:				
Due to other banks	105,106	112,165	719,980	937,251
Customer accounts	2,550,889	54,254	152,137	2,757,280
Debt securities in issue	6,104	-	1,266	7,370
Other borrowed funds	46,934	665,924	43,012	755,870
Other financial and insurance liabilities	44,458	404	1,265	46,127
Subordinated debt	-	50,139	-	50,139
TOTAL FINANCIAL LIABILITIES	**2,753,491**	**882,886**	**917,660**	**4,554,037**
NET POSITION	**528,715**	**(551,796)**	**88,763**	
CREDIT RELATED COMMITMENTS	**1,223,637**	**42,401**	**162,002**	

Assets, liabilities and credit related commitments have generally been based on the country, in which the counterparty is located. Balances with Azerbaijani counterparties actually outstanding to/from off-shore companies of these Azerbaijani counterparties are allocated to the caption "Azerbaijan". Cash on hand and premises and equipment have been allocated based on the country, in which they are physically held.

The geographical concentration of the Group's consolidated assets and liabilities as at December 31, 2010 is set out below:

	The Republic of Azerbaijan	OECD countries	Other non-OECD countries	Total
FINANCIAL ASSETS:				
Cash and cash equivalents	206,017	450,868	20,945	677,830
Mandatory cash balances with the National/Central banks	8,577	-	3,143	11,720
Due from other banks	22,707	23,992	84,663	131,362
Loans and advances to customers	2,631,085	58,536	613,810	3,303,431
Financial assets at fair value through profit or loss	60	-	1,218	1,278
Other financial and insurance assets	5,339	-	1,247	6,586
TOTAL FINANCIAL ASSETS	**2,873,785**	**533,396**	**725,026**	**4,132,207**
FINANCIAL LIABILITIES:				
Due to other banks	117,194	170,699	734,582	1,022,475
Customer accounts	1,963,769	32,072	115,774	2,111,615
Debt securities in issue	7,041	-	-	7,041
Other borrowed funds	39,695	751,182	34,780	825,657
Other financial and insurance liabilities	50,729	1,564	1,362	53,655
Subordinated debt	-	50,866	15,968	66,834
TOTAL FINANCIAL LIABILITIES	**2,178,428**	**1,006,383**	**902,466**	**4,087,277**
NET POSITION	**695,357**	**(472,987)**	**(177,440)**	
CREDIT RELATED COMMITMENTS	**1,252,640**	**125,498**	**200,746**	

Other risk concentrations

As a part of its management of risk concentrations, management monitors concentrations of credit risk on the basis of the statutory limits set by the CBAR, as follows:

- The aggregate amount of loans, the fair value of the collateral of which is greater than the carrying amount of the loan, may not exceed 20% of the total statutory capital calculated in accordance with the CBAR's guidance;
- The aggregate amount of loans, the fair value of the collateral, calculated as per CBAR guidelines, of which is less than the carrying amount of the loan, may not exceed 7% of the total statutory capital calculated in accordance with the CBAR's guidance; and
- The ratio of the aggregate amount of significant loans (loans with a carrying amount of AZN 1 million and above) to the statutory capital calculated in accordance with the CBAR's guidance may not be higher than 8.

For IFRS reporting purposes, the Group, monitors concentrations of credit risk by obtaining reports listing exposures to borrowers with aggregated loan balances in excess of 10% of net assets. The Group discloses any such concentrations within the respective notes in its consolidated financial statements.

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in settling its financial obligations. It refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments and insurance obligations as they actually fall due. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of financial institutions.

In order to manage liquidity risk, the Group performs daily monitoring of future expected cash flows on clients' and banking operations, which is part of the assets/liabilities management process. The Executive Board and Supervisory Board set limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals under both normal and stressed conditions. They also set parameters for the risk diversification of the liability base.

The CBAR has in place minimum levels of liquidity required. Loan agreements with international financial institutions also have minimum liquidity covenants in their agreements with the Group. As at December 31, 2011, management consider that the Group was in compliance with all these covenants, except for those disclosed in Note 28.

The Group's liquidity policy is comprised of the following:

- Projecting cash flows and maintaining the level of liquid assets necessary to ensure liquidity in various time-bands;
- Maintaining a funding plan commensurate with the Group's strategic goals;
- Maintaining a diverse range of funding sources thereby increasing the Group's borrowing capacity, domestically as well as from foreign sources;
- Maintaining highly liquid and high-quality assets;
- Adjusting its product base by time bands against available funding sources;
- Daily monitoring of liquidity ratios against regulatory requirements;
- Constant monitoring of asset and liability structures by time-bands.

The Accounting and Control Department within the Group is charged with the following responsibilities:

- Monitoring compliance with the liquidity requirements of the CBAR as well as the liquidity requirements through covenants contained in the agreements with foreign lenders;
- Daily reports to management, including reporting to management on the forecast levels of cash flows in the main currencies (AZN, USD, EUR), cash positions, balance sheet changes;
- Constantly controlling/monitoring the level of liquid assets;
- Monitoring of deposit and other liability concentrations;
- Maintaining a plan for the instant increase of cash to provide liquidity under stressed conditions.

ALCO is responsible for ensuring that the Accounting and Control Department properly manages the Group's consolidated liquidity position. Decisions on liquidity positions and management are made by the Executive Board. Funding plans are approved by the Supervisory Board.

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

	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 12 months to 5 years	Over 5 years	Total
Liabilities						
Due to other banks	388,862	293,916	211,855	59,738	9,953	964,324
Customer accounts	1,535,356	150,822	639,459	556,398	7,156	2,889,191
Debt securities in issue	169	1,439	1,032	2,640	8,193	13,473
Other borrowed funds	363,744	95,620	257,507	68,741	16,688	802,300
Other financial and insurance liabilities	39,384	5,136	1,099	508	-	46,127
Subordinated debt	347	694	3,122	16,649	51,954	72,766
Commitments to extend credit and undrawn credit lines	97,551	-	174	-	-	97,725
Import letters of credit	559,640	-	-	-	-	559,640
Guarantees issued	767,062	612	2,294	707	-	770,675
Total potential future payments for financial obligations	**3,752,115**	**548,239**	**1,116,542**	**705,381**	**93,944**	**6,216,221**

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

	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 12 months to 5 years	Over 5 years	Total
Liabilities						
Due to other banks	714,684	116,875	189,936	20,592	7,810	1,049,897
Customer accounts	1,148,862	117,589	496,497	477,876	3,927	2,244,751
Debt securities in issue	22	215	1,482	3,677	7,340	12,736
Other borrowed funds	432,991	20,726	319,858	69,845	72,827	916,247
Other financial and insurance liabilities	43,059	8,954	1,009	633	-	53,655
Subordinated debt	16,371	826	3,717	19,824	57,037	97,775
Commitments to extend credit and undrawn credit lines	150,121	-	-	-	-	150,121
Import letters of credit	604,114	-	-	-	-	604,114
Guarantees issued	824,649	-	-	-	-	824,649
Total potential future payments for financial obligations	**3,934,873**	**265,185**	**1,012,499**	**592,447**	**148,941**	**5,953,945**

The Group does not use the above undiscounted maturity analysis to manage liquidity. Instead, the Group monitors contractual maturities of carrying values of assets and liabilities.

The following two tables show carrying amounts of financial assets and financial liabilities of the Group grouped on the basis of the remaining period from the end of the reporting period to their contractual maturity date.

The analysis of carrying values of assets and liabilities by contractual maturities may be summarised as follows as at December 31, 2011:

	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	Over 12 months	Total
FINANCIAL ASSETS:					
Cash and cash equivalents	391,381	-	-	-	391,381
Mandatory cash balances with the National/Central banks	103,907	-	-	-	103,907
Due from other banks	76,780	21,224	2,246	1,415	101,665
Loans and advances to customers	467,538	838,738	1,102,185	1,599,723	4,008,184
Financial assets at fair value through profit or loss	-	-	1,228	4,629	5,857
Available-for-sale investments	-	1,573	2,478	-	4,051
Other financial and insurance assets	4,415	259	-	-	4,674
TOTAL FINANCIAL ASSETS	**1,044,021**	**861,794**	**1,108,137**	**1,605,767**	**4,619,719**
FINANCIAL LIABILITIES:					
Due to other banks	386,838	361,564	134,914	53,935	937,251
Customer accounts	1,540,031	392,441	334,741	490,067	2,757,280
Debt securities in issue	185	1,706	487	4,992	7,370
Other borrowed funds	366,110	258,626	66,658	64,476	755,870
Other financial and insurance liabilities	39,384	5,136	1,099	508	46,127
Subordinated debt	-	-	-	50,139	50,139
TOTAL FINANCIAL LIABILITIES	**2,332,548**	**1,019,473**	**537,899**	**664,117**	**4,554,037**
NET LIQUIDITY GAP AS AT DECEMBER 31, 2011	**(1,288,527)**	**(157,679)**	**570,238**	**941,650**	
CUMULATIVE LIQUIDITY GAP AS AT DECEMBER 31, 2011	**(1,288,527)**	**(1,446,206)**	**(875,968)**	**65,682**	

The analysis of carrying values of assets and liabilities by contractual maturities may be summarised as follows as at December 31, 2010:

	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	Over 12 months	Total
FINANCIAL ASSETS:					
Cash and cash equivalents	676,830	1,000	-	-	677,830
Mandatory cash balances with the National/Central banks	11,720	-	-	-	11,720
Due from other banks	104,899	8,299	17,182	982	131,362
Loans and advances to customers	697,115	632,620	509,781	1,463,915	3,303,431
Financial assets at fair value through profit or loss	1,194	-	-	84	1,278
Other financial and insurance assets	6,151	435	-	-	6,586
TOTAL FINANCIAL ASSETS	**1,497,909**	**642,354**	**526,963**	**1,464,981**	**4,132,207**
FINANCIAL LIABILITIES:					
Due to other banks	712,939	187,665	89,975	31,896	1,022,475
Customer accounts	1,122,571	340,251	217,492	431,301	2,111,615
Debt securities in issue	7	491	856	5,687	7,041
Other borrowed funds	429,150	87,842	115,146	193,519	825,657
Other financial and insurance liabilities	43,060	8,521	1,442	632	53,655
Subordinated debt	15,958	-	-	50,876	66,834
TOTAL FINANCIAL LIABILITIES	**2,323,685**	**624,770**	**424,911**	**713,911**	**4,087,277**
NET LIQUIDITY GAP AS AT DECEMBER 31, 2010	**(825,776)**	**17,584**	**102,052**	**751,070**	
CUMULATIVE LIQUIDITY GAP AS AT DECEMBER 31, 2010	**(825,776)**	**(808,192)**	**(706,140)**	**44,930**	

The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. It is unusual for banks ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Group and its exposure to changes in interest and exchange rates.

Management believes that in spite of a substantial portion of customers accounts being on demand, diversification of these deposits by number and type of depositors, and the past experience of the Group would indicate that these customer accounts provide a long-term and stable source of funding for the Group. Customer accounts are classified in the above analysis based on contractual maturities. However, in accordance with the Civil Code of the Republic of Azerbaijan, individuals have a right to withdraw their deposits prior to maturity if they forfeit their right to a certain portion of accrued interest.

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Group does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

As set out in Note 28, included in the above analysis of maturities, total borrowings of AZN 344,750 thousand (December 31, 2010: AZN 445,620 thousand and subordinated debt 15,958 thousand) are included as "on demand" due to breaches of certain covenants imposed in those borrowing agreements as at December 31, 2011. The contractual maturity dates are set out in Note 15 for the individual term borrowings and in Note 18 for the subordinated debt of the Group.

27. MANAGEMENT OF CAPITAL

The objectives of management when managing the Group's capital are (i) to comply with the capital requirements set by the CBAR, (ii) to safeguard the Group's ability to continue as a going concern and (iii) to maintain a sufficient capital base to achieve a capital adequacy ratio based on Basel I of at least 8%. Compliance with capital adequacy ratios set by the CBAR is monitored monthly with reports outlining their calculation reviewed and signed by the Head of Audit Committee, Bank's Finance Director, First Deputy of Chairman of the Board, Head of Internal Audit Department and Head of Accounting and Control Department. The other objectives of capital management are evaluated annually.

Under the current capital requirements set by the CBAR banks have to: (a) hold the minimum level of total statutory capital of AZN 10,000 thousand (December 31, 2010: AZN 10,000 thousand); (b) maintain a ratio of regulatory capital to risk weighted assets ("statutory capital ratio") at or above a prescribed minimum of 12% (December 31, 2010: 12%) and (c) maintain a ratio of tier-1 capital to the risk-weighted assets (the 'Tier-1 capital ratio') at or above the prescribed minimum of 6% (December 31, 2010: 6%).

Under the current capital requirements set by the CBRF, banks have to (i) comply with the capital requirements set by the Central Bank of the Russian Federation, (ii) safeguard the Bank's ability to continue as a going concern and (iii) maintain a sufficient capital base to achieve a capital adequacy ratio based on the Basel I of at least 8%.

The Group and the Bank are also subject to requirements established by covenants stated in loan agreements, including capital adequacy levels calculated in accordance with the requirements of the Basle Accord, as defined in the International Convergence of Capital Measurement and Capital Standards (updated April 1998). The composition of the Group's capital calculated in accordance with Basel I, based on the consolidated financial statements of the Group, is as follows:

	December 31, 2011	December 31, 2010
Tier 1 capital		
Share capital	240,000	240,000
Retained earnings/(accumulated deficit)	13,694	(6,479)
Non-controlling interest	2,037	1,130
Less: Intangible assets	(5,860)	(4,874)
Total qualifying Tier 1 capital	**249,871**	**229,777**
Tier 2 capital		
Reserves (1.25% of total risk-weighted assets)	63,077	56,272
Revaluation reserve for premises	21,074	19,939
Subordinated debt	50,139	66,834
Total qualifying Tier 2 capital limited to 100% of Tier 1 capital	**134,290**	**143,045**
Less: Investments in equity shares	(649)	(1,439)
Total regulatory capital	**383,512**	**371,383**
Risk-weighted assets:		
On-balance sheet	4,009,597	3,390,695
Off-balance sheet	1,036,549	1,111,067
Total risk-weighted assets	**5,046,146**	**4,501,762**
Capital Ratios:		
Tier 1 capital	4.95%	5.10%
Total capital	7.60%	8.25%

As an integral part of the Bank's capital management procedures the Finance Director performs regular monitoring of compliance with the externally imposed capital requirements and the monitoring reports are reviewed and approved by Head of Audit Committee, Chairman of the Board of Directors and the Head of Internal Audit Department. The Group and the Bank have complied with all externally imposed capital requirements throughout 2011 and 2010, except as stated in Note 28.

28. CONTINGENCIES AND COMMITMENTS

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

Taxation – Commercial legislation of the Republic of Azerbaijan, including tax legislation, may allow more than one interpretation. In addition, there is a risk of tax authorities making arbitrary judgments of business activities. If a particular treatment, based on management's judgment of the Group's business activities, was to be challenged by the tax authorities, the Group may be assessed additional taxes, penalties and interest.

Such uncertainty may relate to the valuation of financial instruments, valuation of provision for impairment losses and the market pricing of deals. Additionally such uncertainty may relate to the valuation of temporary differences on the provision and recovery of the provision for impairment losses on loans to customers and receivables, as an underestimation of the taxable profit. The management of the Bank believes that it has accrued all tax amounts due and therefore no allowance has been made in the financial statements.

Generally, taxpayers are subject to tax audits with respect to three calendar years preceding the year of the audit. However, completed audits do not exclude the possibility of subsequent additional tax audits performed by upper-level tax inspectorates reviewing the results of tax audits of their subordinate tax inspectorates. In the case of criminal investigation statute of limitation may be extended up to seven years based on the court decision.

Operating environment – Emerging markets such as Azerbaijan are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. As has happened in the past, actual or perceived financial problems or an increase in the perceived risks associated with investing in emerging economies could adversely affect the investment climate in Azerbaijan and the Azerbaijan's economy in general.

Laws and regulations affecting businesses in Azerbaijan continue to change rapidly. Tax, currency and customs legislation within Azerbaijan are subject to varying interpretations, and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in Azerbaijan. The future economic direction of Azerbaijan is heavily influenced by the economic, fiscal and monetary policies adopted by the government, together with developments in the legal, regulatory, and political environment.

The global financial system continues to exhibit signs of deep stress and many economies around the world are experiencing lesser or no growth than in prior years. Additionally there is increased uncertainty about the creditworthiness of some sovereign states in the Eurozone and financial institutions with exposure to the sovereign debt of such states. These conditions could slow or disrupt the Azerbaijan's economy, adversely affect the Group's access to capital and cost of capital for the Group and, more generally, its business, results of operations, financial condition and prospects.

Because Azerbaijan produces and exports large volumes of oil and gas, Azerbaijan's economy is particularly sensitive to the price of oil and gas on the world market which has fluctuated significantly during 2011 and 2010.

Compliance with covenants – The Bank is subject to certain covenants related primarily to its borrowings. Non-compliance with such covenants may result in negative consequences for the Group including, growth in the cost of borrowings and declaration of default. As at December 31, 2011 and at certain times during the year then ended the Bank was in breach of the restrictions that limit the maximum exposure of the Bank to (i) tier-1 capital adequacy ratio; and (ii) total capital adequacy ratio.

As at December 31, 2011, as disclosed in these consolidated financial statements, tier-1 capital adequacy ratio comprised 4.95% (December 31, 2010: 5.10%) and total adequacy capital was 7.60% (December 31, 2010: 8.25%). As a result, the Group was not in compliance with these covenants as at December 31, 2011 and 2010, and at certain other times during the reporting periods then ended. As a result of cross-default clauses being included in certain other of the Group's borrowing and subordinated debt agreements, the agreements provide for these other lenders to have the right to declare some or all of their loans repayable on demand.

As set out in Note 26, total borrowings of AZN 344,750 thousand (December 31, 2010: AZN 445,620 thousand and subordinated debt of AZN15,958 thousand) are included as "on demand" due to breaches of certain covenants imposed in those borrowing agreements and subordinated debt agreements as at December 31, 2011. Management believes that subordinated debt will not be required to be repaid prior to the contractual maturity date as set out in the relevant agreement.

The Bank did not achieve full compliance with all statutory ratios neither as at December 31, 2011 nor as at December 31, 2010. The CBAR has a right to impose monetary penalties on the Bank and in case of repeated and continued breaches it may ultimately withdraw the banking license of the Bank if the Bank does not achieve full compliance with the statutory ratios.

Credit related commitments – The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Group on behalf of a customer authorising a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods, to which they relate, or cash deposits and, therefore, carry less risk than a direct borrowing.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit related commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments. Outstanding credit related commitments are, as follows:

	December 31, 2011	**December 31, 2010**
Import letters of credit	559,640	604,114
Guarantees issued	770,675	824,649
Commitments to extend credit and undrawn credit lines	97,725	150,121
Total credit related commitments	**1,428,040**	**1,578,884**

The total outstanding contractual amount of undrawn credit lines, letters of credit, and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded. Credit related commitments are denominated in currencies as follows:

	December 31, 2011	**December 31, 2010**
Azerbaijani Manats	144,541	130,228
US Dollars	843,102	1,054,396
Euro	397,206	374,214
Other	43,191	20,046
Total	**1,428,040**	**1,578,884**

As at December 31, 2011, the Group had a significant concentration of import letters of credit of AZN 531,534 thousand issued to 20 entities or 95.0% of total import letters of credit (December 31, 2010: import letters of credit of AZN 583,628 thousand issued to 20 entities or 96.6% of total import letters of credit). As at December 31, 2011, the Group also had a significant concentration of guarantees of AZN 697,005 thousand issued to 20 entities or 90.4% of total guarantees issued (December 31, 2010: guarantees of AZN 620,479 thousand issued to 20 entities or 75.2% of total guarantees).

As at December 31, 2011, credit related commitments of AZN 293,766 thousand (December 31, 2010: AZN 317,696 thousand) are secured by blocked customer deposits. Refer to Note 13.

Intermediary loans – As at December 31, 2011, the Group had borrowed funds amounting to AZN 869,698 thousand (December 31, 2010: AZN 1,287,118 thousand) on behalf of the Government of the Republic of Azerbaijan from certain financial institutions and state organizations for the purposes of providing intermediary loans to state-owned enterprises and government bodies of the Republic of Azerbaijan. The loan agreements signed between the Group and these financial institutions and state organizations are secured by unconditional letters of guarantee of the Government of the Republic of Azerbaijan, whereby the Government acts as the primary obligor in relation to these borrowings or secured by customer deposits of the borrowing state organization. As a result, the Group acts as a loan-servicing agent for the Government of the Republic of Azerbaijan by transferring collected principal and interest payments to financial institutions and state organizations and earns commission income on servicing these intermediary loans.

As the Group does not receive any interest margin and does not bear the risks for these intermediary loans, the Group has recorded these intermediary loans on off-balance sheet accounts. Similarly funds received by the Group to finance these intermediary loans in the corresponding amounts have also been recorded on off balance sheet accounts.

Funds borrowed by the Group for the purposes of providing intermediary loans are as follows:

	December 31, 2011	December 31, 2010
Funds borrowed from CBAR and given to two state organizations	869,698	952,000
Funds borrowed from one state organization and given to another state organization	-	335,118
Total funds borrowed for the purposes of providing intermediary loans and transferred to off-balance sheet accounts	**869,698**	**1,287,118**

29. 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.

Assets for which fair value approximates carrying value

For financial assets and liabilities that have a short term maturity (less than 3 months), it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and savings accounts without a maturity.

Due from other banks, due to other banks, customer accounts, debt securities in issue, other borrowed funds and subordinated debt

The carrying value of due from other banks, due to other banks, customer accounts, debt securities in issue, other borrowed funds and subordinated debt for term deposits placed during the period of one month to the reporting date is assumed to be fair value amount for them. The fair value of the other term deposits is estimated by application of market interest rates when the deposits were placed with the current market rates offered on similar deposits.

Other financial assets and liabilities

Other financial assets and liabilities are mainly represented by short-term receivables and payables, therefore the carrying amount is assumed to be reasonable estimate of their fair value.

Loans and advances to customers

Loans and advances to personal customers are made both at variable and at fixed rates. As there is no active secondary market in Azerbaijan for such loans and advances, there is no reliable market value available for this portfolio.

- Variable rate – Management believes that carrying rate may be assumed to be fair value.
- Fixed rate – Certain of the loans secured are at a fixed rate. Fair value has ben estimated by reference to the market rates available at the reporting date for similar loans of maturity equal to the remaining fixed period.

Except as detailed below, management of the Bank considers that the fair value of financial assets and liabilities approximates their carrying value:

	December 31, 2011		December 31, 2010	
	Carrying value	Fair value	Carrying value	Fair value
Due from other banks	108,654	101,665	138,189	131,362

Fair value measurements recognised in the consolidated statement of financial position

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- 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).

Class of Financial Asset/Liability	December 31, 2011			December 31, 2010		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Other financial assets						
- Financial assets at fair value through profit or loss	5,857	-	-	1,278	-	-
- Available-for-sale investments	4,051	-	-	-	-	-
- Currency swap agreements	-	1,414	-	-	502	-

30. RELATED PARTY TRANSACTIONS

Parties are generally considered to be related if the parties are under common control or one party has the ability to control the other party or can exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

As at December 31, 2011, the outstanding balances with shareholders are substantially all with the Parent.

	Shareholders	Management	Government bodies and state-owned entities	Associates
Cash and cash equivalents	-	-	26,427	-
Mandatory cash balances with the CBAR	-	-	94,423	-
Gross amount of loans and advances to customers (contractual interest rate: 1 - 25% p.a.)	22,430	247	259,563	22,130
Provisions for loan impairment	(481)	(5)	(78,349)	(5,327)
Current income tax asset	-	-	1,177	-
Due to other banks				
Correspondent accounts of other banks	1,825	-	82,170	-
Customer accounts				
Current/settlement accounts	-	23	545,685	-
Term deposits (contractual interest rate: 0.18 - 9% p.a.)	-	21	311,990	-
Other borrowed funds (contractual interest rate: 1% p.a.)	-	-	45,582	-

The income and expense items with related parties for the year 2011 were as follows:

	Shareholders	Management	Government bodies and state-owned entities	Associates
Interest income	2,529	-	24,873	945
Interest expense	-	-	(9,896)	-
Provision for impairment of loans to customers	(8,255)	-	(3,766)	-
Fee and commission income	1	-	21,231	41
Insurance related commission expense	-	-	(9)	-
Staff costs	-	(638)	-	-
Operating expenses	-	-	(1,656)	-
Income tax expense	-	-	(10,421)	-

As at December 31, 2011, other rights and obligations with related parties were as follows:

	Government bodies and state-owned entities
Guarantees issued	442,215
Import letters of credit	276,731
Commitments to extend credit and undrawn credit lines	12,140

As at December 31, 2010, the outstanding balances with shareholders are substantially all with the Parent.

	Shareholders	Management	Government bodies and state-owned entities	Associates
Cash and cash equivalents	-	-	95,310	-
Mandatory cash balances with the CBAR	-	-	8,577	-
Gross amount of loans and advances to customers (contractual interest rate: 1 - 25% p.a.)	19,936	343	240,756	20,516
Provision for loan impairment	(1,064)	-	(75,717)	(4,556)
Current income tax asset	-	-	785	-
Due to other banks				
Correspondent accounts of other banks	-	-	80,966	-
Customer accounts				
Current/settlement accounts	-	-	629,604	-
Term deposits (contractual interest rate: 2 - 7% p.a.)	-	-	347,338	-
Other borrowed funds (contractual interest rate: 1% p.a.)	-	-	28,761	-
Current income tax liability	-	-	424	-

The income and expense items with related parties for the year 2010 were as follows:

	Shareholders	Management	Government bodies and state-owned entities	Associates
Interest income	7,238	11	49,289	1,050
Interest expense	-	-	(4,047)	-
Provision for impairment of loans to customers	(7,045)	-	(15,276)	(24,606)
Fee and commission income	-	-	34,488	7
Insurance related commission expense	-	-	(97)	-
Staff costs	-	(913)	-	-
Other income	-	-	9	-
Operating expenses	-	-	(3,247)	-
Income tax expense	-	-	(15,763)	-

As at December 31, 2010, other rights and obligations with related parties were as follows:

	Government bodies and state-owned entities
Guarantees issued	270,757
Import letters of credit	345,077

The Group is controlled by the Government of the Republic of Azerbaijan. Therefore, in accordance with IAS 24 transactions with the Government, the Ministry of Finance of the Republic of Azerbaijan and state-owned companies of the Republic of Azerbaijan are included in the above related party balances and transactions.

During the year ended December 31, 2011, the total remuneration of members of the Board of Directors and key management personnel of the Group including discretionary compensation amounted to AZN 638 thousand (2010: AZN 810 thousand) and comprised of:

	Year ended December 31, 2011	Year ended December 31, 2010
Short-term benefits:		
- salaries	431	580
- performance bonuses	207	230
Total	**638**	**810**

31. SUBSEQUENT EVENTS

On January 13, 2012 the Board of Directors the Bank decided to increase the share capital of International Insurance Company OJSC by AZN 5,000 thousand

In January 2012 the Bank attracted three deposits from one non-resident bank totaling EUR 7,500 thousand and USD 1,000 thousand which mature in July 2012.

In February 2012 the Bank attracted deposits from two non-resident banks totaling USD 14,500 thousand which mature in December 2012 and February 2014.

On February 21, 2012 the Bank signed a subordinated loan agreement with the Central Bank of the Republic of Azerbaijan totaling AZN 150,000 thousand with maturity of 5 years.

On March 12, 2012 and April 12, 2012 the Bank has attracted two deposits from one non-resident bank totaling to USD 5,200 thousand and EUR 2,470 thousand which mature in March and April 2013, respectively.

On March 12, 2012 and June 13, 2012 the Bank has attracted two deposits from one non-resident bank totaling to USD 100,000 thousand which mature in March and June 2013, respectively .

On March 28, 2012 the Shareholders of the Bank have decided to increase the share capital of the Bank by AZN 100,000 thousand. The increase in capital is realized by issuing an additional 416,666,675 ordinary shares with AZN 0.24 par values each. As at May 31, 2012 the Ministry of Finance, who is the major shareholder of the Bank holding 50.20% of shares prior to the last issue, has purchased all the shares offered to it. After initial offers to all other current shareholders, shares will be publicly issued on the Baku Stock Exchange.

In March 2012 the Bank prolonged four deposit agreements with one non-resident bank and one deposit agreement with another non-resident bank in the amount of EUR 323,000 thousand and USD 10,000 thousand for one year and one month, respectively.

During the period from February 28, 2012 to June 18, 2012 the Bank attracted deposits from two non-resident banks totaling USD 10,873 thousand which mature in June 2013.

On May 8, 2012 the Bank has attracted a deposit from one resident bank totaling to EUR 17,666 thousand which matures in August 2012.