

# **Bank VTB (Azerbaijan) OJSC**

## **Financial statements**

Year ended 31 December 2013  
together with Independent auditors' report

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## Independent auditors' report

### To the Shareholders and Board of Directors of Bank VTB (Azerbaijan) OJSC

We have audited the accompanying financial statements of Bank VTB (Azerbaijan) OJSC, which comprise statement of financial position as of 31 December 2013, and statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

#### **Management's responsibility for the financial statements**

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

#### **Auditors' responsibility**

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

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

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

#### **Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of Bank VTB (Azerbaijan) OJSC as of 31 December 2013, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

*Ernst & Young Holdings (CIS) B.V.*

04 March 2014

**Bank VTB (Azerbaijan) OJSC**  
**Statement of financial position**  
**As of 31 December 2013**  
*(Amounts presented are in thousands of Azerbaijani Manats)*

	<b>Notes</b>	<b>2013</b>	<b>2012</b>
<b>Assets</b>			
Cash and cash equivalents	5	9,277	5,529
Mandatory reserves with Central Bank of the Republic of Azerbaijan		4,197	1,336
Amounts due from credit institutions	6	5,029	3,716
Loans to customers	7	184,113	72,070
Property and equipment	8	1,879	932
Intangible assets	9	1,223	1,204
Deferred income tax assets	10	1,144	-
Other assets	11	459	706
<b>Total assets</b>		<b>207,321</b>	<b>85,493</b>
<b>Liabilities</b>			
Amounts due to credit institutions	12	126,554	53,739
Amounts due to customers	13	31,250	14,360
Other liabilities	11	765	178
Subordinated debts	14	4,378	4,381
<b>Total liabilities</b>		<b>162,947</b>	<b>72,658</b>
<b>Equity</b>			
Share capital	15	50,815	23,815
Accumulated deficit	15	(6,441)	(10,980)
<b>Total equity</b>		<b>44,374</b>	<b>12,835</b>
<b>Total liabilities and equity</b>		<b>207,321</b>	<b>85,493</b>

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

Alexander Yeriomin

Chairman of the Management Board

Ilgar Novruzov

Chief Financial Officer

Ravilya Sharafetdinova

Chief Accountant

04 March 2014

**Bank VTB (Azerbaijan) OJSC**  
**Statement of comprehensive income**  
**For the year ended 31 December 2013**  
*(Amounts presented are in thousands of Azerbaijani Manats)*

	<b>Notes</b>	<b>2013</b>	<b>2012</b>
Interest income		20,264	7,540
Interest expense		(5,717)	(2,406)
<b>Net interest income</b>	17	<b>14,547</b>	<b>5,134</b>
Impairment charge on interest bearing assets	6, 7	(2,394)	(1,444)
<b>Net interest income after impairment charge on interest bearing assets</b>		<b>12,153</b>	<b>3,690</b>
Fee and commission income	18	950	629
Fee and commission expense	18	(184)	(163)
Net gain from foreign currencies:			
- dealing differences, net		250	107
- translation differences, net		2	3
Other income		457	254
<b>Net non-interest income</b>		<b>1,475</b>	<b>830</b>
<b>Operating income</b>		<b>13,628</b>	<b>4,520</b>
Operating expenses	19	(10,233)	(6,813)
<b>Profit/(loss) before income tax expense</b>		<b>3,395</b>	<b>(2,293)</b>
Income tax benefit	10	1,144	-
<b>Net profit/(loss) for the year</b>		<b>4,539</b>	<b>(2,293)</b>
Other comprehensive income/(loss) for the year		-	-
<b>Total comprehensive income/(loss) for the year</b>		<b>4,539</b>	<b>(2,293)</b>

*The accompanying notes on pages 6 to 39 are an integral part of these financial statements.*

**Bank VTB (Azerbaijan) OJSC**  
**Statement of changes in equity**  
**For the year ended 31 December 2013**  
*(Amounts presented are in thousands of Azerbaijani Manats)*

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	<i>Notes</i>	<i>Share capital</i>	<i>Accumulated deficit</i>	<i>Total equity</i>
<b>31 December 2011</b>		<b>23,815</b>	<b>(8,687)</b>	<b>15,128</b>
Total comprehensive loss for the year		-	(2,293)	(2,293)
<b>31 December 2012</b>		<b>23,815</b>	<b>(10,980)</b>	<b>12,835</b>
Total comprehensive income for the year		-	4,539	4,539
Issue of share capital	15	27,000	-	27,000
<b>31 December 2013</b>		<b>50,815</b>	<b>(6,441)</b>	<b>44,374</b>

*The accompanying notes on pages 6 to 39 are an integral part of these financial statements.*

**Bank VTB (Azerbaijan) OJSC**  
**Statement of cash flows**  
**For the year ended 31 December 2013**  
*(Amounts presented are in thousands of Azerbaijani Manats)*

	<i>Notes</i>	<b>2013</b>	<b>2012</b>
<b>Cash flows from operating activities</b>			
Interest received		18,019	7,282
Interest paid		(4,931)	(1,484)
Fees and commissions received		952	629
Fees and commissions paid		(184)	(163)
Realised gain less losses from dealing in foreign currencies		250	107
Other operating income received		398	217
Personnel expenses paid		(6,442)	(4,103)
Other operating expenses paid		(2,388)	(2,036)
<b>Cash flows from operating activities before changes in operating assets and liabilities</b>		<b>5,674</b>	<b>449</b>
<i>Net (increase) / decrease in operating assets</i>			
Amounts due from credit institutions		(1,304)	(4,204)
Mandatory reserves with the Central Bank of the Republic of Azerbaijan		(2,859)	(563)
Loans to customers		(112,275)	(27,185)
Other assets		(46)	163
<i>Net increase / (decrease) in operating liabilities</i>			
Amounts due to credit institutions		72,087	26,020
Customer accounts		16,872	9,855
Other liabilities		79	(17)
<b>Net cash from / (used in) operating activities before income tax</b>		<b>(21,772)</b>	<b>4,518</b>
Income tax paid		-	-
<b>Net cash from / (used in) operating activities</b>		<b>(21,772)</b>	<b>4,518</b>
<b>Cash flows from investing activities</b>			
Purchase of property and equipment		(1,309)	(596)
Purchase of intangible assets		(236)	(489)
<b>Net cash used in investing activities</b>		<b>(1,545)</b>	<b>(1,085)</b>
<b>Cash flows from financing activities</b>			
Proceeds from issuance of new equity shares		27,000	-
Proceeds from subordinated debts		-	1,012
<b>Net cash from financing activities</b>		<b>27,000</b>	<b>1,012</b>
Effect of exchange rates changes on cash and cash equivalents		65	3
<b>Net increase in cash and cash equivalents</b>		<b>3,748</b>	<b>4,448</b>
<b>Cash and cash equivalents, beginning</b>		<b>5,529</b>	<b>1,081</b>
<b>Cash and cash equivalents, ending</b>	5	<b>9,277</b>	<b>5,529</b>

*The accompanying notes on pages 6 to 39 are an integral part of these financial statements.*

**Bank VTB (Azerbaijan) OJSC**  
**Notes to the financial statements**

*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*

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**1. Principal activities**

**Bank VTB (Azerbaijan) Open Joint Stock Company** (the “Bank”) was formed as “AF-Bank” OJSC on 14 December 1993 under the laws of the Republic of Azerbaijan. The Bank operates under a general banking license under registration number 162 issued by the Central Bank of the Republic of Azerbaijan (“CBAR”) on 22 October 1993.

The Bank accepts deposits from the public and extends credit, transfers payments in Azerbaijan and abroad, exchanges currencies and provides other banking services to its commercial and retail customers.

The Bank participates in the state deposit insurance scheme, which was introduced by the Azeri Law, “Insurance of individual deposits in the Republic of Azerbaijan” dated 29 December 2006. Insurance covers Bank’s liabilities to individual depositors for the amount up to 30 thousands of Azerbaijani Manats for each individual in case of business failure and revocation of the CBAR banking license.

On 27 October 2007 two companies registered in Cyprus Balmwell Limited LLC and Nies Ventures Limited LLC acquired 99.8% of the Bank from its former shareholders. On 31 July 2008 and on 9 November 2009, “Bank VTB” OJSC (Russian Federation) and “Ata Holding” OJSC acquired 51% and 48.99% of the Bank, respectively, from Nies Ventures Limited LLC and Balmwell Limited LLC.

The Bank has 5 branches (2012 - 3 branches) within the Republic of Azerbaijan. The Bank had 274 employees as of 31 December 2013 (2012 - 180).

The Bank’s registered legal address is 38, Khatai Avenue, Baku, the Republic of Azerbaijan.

As of 31 December 2013 and 2012 the following shareholders owned the share capital of the Bank:

<b>Shareholder</b>	<b>2013</b>	<b>2012</b>
	<b>%</b>	<b>%</b>
Bank VTB OJSC (Russian Federation)	51.00	51.00
Ata Holding OJSC	48.99	48.99
Kamilov Ashraf	0.01	0.01
<b>Total</b>	<b>100.00</b>	<b>100.00</b>

The ultimate controlling party of the Bank is the government of the Russian Federation as at the date of this report through Bank VTB OJSC (Russian Federation).

**2. Basis of preparation**

*General*

These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”). The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below.

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



### **3. Summary of accounting policies**

#### **Changes in accounting policies**

The Bank has adopted the following amended IFRS during the year:

##### *IFRS 13 Fair Value Measurement*

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The application of IFRS 13 has not materially impacted the fair value measurements carried out by the Bank.

IFRS 13 also requires specific disclosures on fair values, some of which replace existing disclosure requirements in other standards, including IFRS 7 *Financial Instruments: Disclosures*. Some of these disclosures are specifically required for financial instruments by IAS 34.16A(j).

##### *IAS 1 Clarification of the Requirement for Comparative Information (amendment)*

These amendments clarify the difference between voluntary additional comparative information and the minimum required comparative information. An entity must include comparative information in the related notes to the financial statements when it voluntarily provides comparative information beyond the minimum required comparative period. The amendments clarify that the opening statement of financial position, presented as a result of retrospective restatement or reclassification of items in financial statements does not have to be accompanied by comparative information in the related notes. The amendments affect presentation only and have no impact on the Bank's financial position or performance.

##### *Amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities*

These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognized financial instruments that are set off in accordance with IAS 32 *Financial Instruments: Presentation*. The disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreements, irrespective of whether they are set off in accordance with IAS 32. These amendments had no impact on the Banks' financial position or performance.

#### **Fair value measurement**

The Bank measures financial instruments, such as trading and available-for-sale securities, derivatives and non-financial assets such as investment property, at fair value at each balance sheet date.

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

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

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

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)**

*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*

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**3. Summary of accounting policies (continued)****Fair value measurement (continued)**

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

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

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

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

**Financial assets***Initial recognition*

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. The Bank determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

*Date of recognition*

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

*Financial assets at fair value through profit or loss*

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

*Held-to-maturity investments*

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Bank has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held-to-maturity investments are subsequently measured at amortized cost. Gains and losses are recognized in profit or loss when the investments are impaired, as well as through the amortization process.

### **3. Summary of accounting policies (continued)**

#### **Financial assets (continued)**

##### *Loans and receivables*

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

##### *Available-for-sale financial assets*

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

##### *Reclassification of financial assets*

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

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

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

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

##### *Cash and cash equivalents*

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

##### *Mandatory reserves with the Central Bank of the Republic of Azerbaijan*

Mandatory cash balances in AZN and foreign currency held with the CBAR are carried at amortized cost and represent non-interest bearing mandatory reserve deposits, which are not available to finance the Bank's day-to-day operations, and hence are not considered as part of cash and cash equivalents for the purpose of the statement of cash flows.

### **3. Summary of accounting policies (continued)**

#### **Financial assets (continued)**

##### *Derivative financial instruments*

In the normal course of business, the Bank enters into various derivative financial instruments including, forwards, swaps and options in the foreign exchange. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the statement of profit or loss comprehensive income as net gains / (losses) from trading securities or net gains / (losses) from foreign currencies dealing, depending on the nature of the instrument.

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair on the trading portfolio with changes in fair value recognised in profit or loss.

##### *Borrowings*

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include due to credit institutions, customer accounts and subordinated debts. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the borrowings are derecognised as well as through the amortisation process.

##### *Operating leases - Bank as lessee*

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

##### *Measurement of financial instruments at initial recognition*

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

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

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

### **3. Summary of accounting policies (continued)**

#### **Financial assets (continued)**

##### *Offsetting of financial instruments*

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

##### *Impairment of financial assets*

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

##### *Amounts due from credit institutions and loans to customers*

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

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

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

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

### **3. Summary of accounting policies (continued)**

#### **Financial assets (continued)**

##### *Amounts due from credit institutions and loans to customers (continued)*

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

##### *Held-to-maturity financial investments*

For held-to-maturity investments the Bank assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognised in the profit or loss.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, any amounts formerly charged are credited to the statement of profit or loss.

##### *Available-for-sale financial investments*

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

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

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

### **3. Summary of accounting policies (continued)**

#### **Financial assets (continued)**

##### *Renegotiated loans*

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

The accounting treatment of such restructuring is as follows:

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

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

#### **Derecognition of financial assets and liabilities**

##### *Financial assets*

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

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

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

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

**Bank VTB (Azerbaijan) OJSC**

**Notes to the financial statements (continued)**

*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*

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**3. Summary of accounting policies (continued)**

**Derecognition of financial assets and liabilities (continued)**

*Financial liabilities*

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

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

*Financial guarantees*

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

Any increase in the liability relating to financial guarantees is taken to the statement of profit or loss. The premium received is recognised in profit or loss on a straight-line basis over the life of the guarantee.

*Taxation*

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

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

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

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

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

*Property and equipment*

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

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



**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)**

*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*

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**3. Summary of accounting policies (continued)****Derecognition of financial assets and liabilities (continued)***Property and equipment (continued)*

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

	<u>Percentage</u>
Leasehold improvements	33%
Computer equipment	25%
Furniture and fixtures	25%
Motor vehicles	25%
Other property and equipment	20%

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

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

*Intangible assets*

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives of 3 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

*Provisions*

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

*Share capital*

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

*Contingencies*

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

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)**

*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*

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**3. Summary of accounting policies (continued)****Derecognition of financial assets and liabilities (continued)***Recognition of income and expenses*

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

*Interest and similar income and expense*

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

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

*Fee and commission income*

The Bank earns fee and commission income from a diverse range of services it provides to its customers. These fees include commission income for provision of the following services: cash withdrawals, consulting and expert services, settlement operations, fees charged for transactions with plastic cards and etc. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

*Foreign currency translation*

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

Differences between the contractual exchange rate of a transaction in a foreign currency and the CBAR exchange rate on the date of the transaction are included in net gain / (losses) from foreign currencies-dealing. The official CBAR exchange rates at 31 December 2013 and 31 December 2012 were as follows:

	<u>31 December 2013</u>	<u>31 December 2012</u>
USD/AZN	0.7845	0.7850
EUR/AZN	1.0780	1.0377
RUR/AZN	0.0241	0.0258

## **Bank VTB (Azerbaijan) OJSC**

### **Notes to the financial statements (continued)**

*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*

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### **3. Summary of accounting policies (continued)**

#### **Future changes in accounting policies**

*Standards and interpretations issued but not yet effective*

##### *IFRS 9 “Financial Instruments”*

IFRS 9, as issued, reflects the first phase of the IASB’s work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but Amendments to IFRS 9 Mandatory Effective Date of IFRS 9 and Transition Disclosures, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the IASB is addressing hedge accounting and impairment of financial assets. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Bank’s financial assets, but will not have an impact on classification and measurements of the Bank’s financial liabilities. The Bank will quantify the effect in conjunction with the other phases, when the final standard including all phases is issued.

##### *Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)*

These amendments are effective for annual periods beginning on or after 1 January 2014 provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. It is not expected that this amendment would be relevant to the Bank, since none of the entities in the Bank does not qualify to be an investment entity under IFRS 10.

##### *IAS 32 Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32*

These amendments clarify the meaning of “currently has a legally enforceable right to set-off” and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting. These are effective for annual periods beginning on or after 1 January 2014. These amendments are not expected to be relevant to the Bank.

##### *IFRIC Interpretation 21 Levies (IFRIC 21)*

IFRIC 21 clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. IFRIC 21 is effective for annual periods beginning on or after 1 January 2014. The Bank does not expect that IFRIC 21 will have a material impact on its financial statements.

##### *IAS 39 Novation of Derivatives and Continuation of Hedge Accounting – Amendments to IAS 39*

These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. These amendments are effective for annual periods beginning on or after 1 January 2014. The Bank has not novated its derivatives during the current period. However, these amendments would be considered for future novations.

### **4. Significant accounting judgments and estimates**

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

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)**

*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*

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**4. Significant accounting judgments and estimates (continued)***Allowance for loan impairment*

The Bank regularly reviews its loans to assess impairment. The Bank uses its experienced judgment to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Bank uses its experienced judgment to adjust observable data for a group of loans or receivables to reflect current circumstances.

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

*Initial recognition of related party transactions*

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

*Deferred tax assets*

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits together with future tax planning strategies. If actual results differ from those estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected. In the event that an assessment of future utilization indicates that the carrying amount of deferred tax assets must be reduced, this reduction is recognised in the statement of comprehensive income.

**5. Cash and cash equivalents**

Cash and cash equivalents comprise:

	<b>2013</b>	<b>2012</b>
Cash on hand	2,400	1,206
Current accounts with the Central Bank of the Republic of Azerbaijan	574	1,017
Current accounts with other banks	6,303	3,306
<b>Cash and cash equivalents</b>	<b>9,277</b>	<b>5,529</b>

Current accounts with other banks consist of non-interest bearing correspondent account balances with resident and non-resident banks in the amount of AZN 81 (2012 - AZN 2,106) and AZN 6,222 (2012 - AZN 1,200), respectively.

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)**

*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*

**6. Amounts due from credit institutions**

Amounts due from credit institutions comprise:

	<u>2013</u>	<u>2012</u>
Loans to banks	5,888	4,668
Other amounts	29	29
	<u>5,917</u>	<u>4,697</u>
Less – Allowance for impairment	(888)	(981)
<b>Amounts due from credit institutions</b>	<b><u>5,029</u></b>	<b><u>3,716</u></b>

As of 31 December 2013 inter-bank loans include AZN 5,888 (2012- AZN 4,668) placed with two (2012- five) resident banks with an average effective annual interest rate of 7% (2012- 10%).

Other amounts represent blocked accounts placed to secure settlement operations and security against guarantees.

The movements in allowance for impairment charge on amounts due from credit institutions were as follows:

	<u>2013</u>	<u>2012</u>
<b>1 January</b>	<b>981</b>	<b>-</b>
Charge / (recovery)	(93)	981
<b>31 December</b>	<b><u>888</u></b>	<b><u>981</u></b>

As of 31 December 2012 the Bank placed AZN 981 in interbank loan with one of local commercial banks with effective annual interest rate of 10% p.a. The loan was totally impaired at the end of the prior reporting period. During current reporting period AZN 93 was repaid, therefore loan balance and allowance respectively decreased.

**7. Loans to customers**

Loans to customers comprise:

	<u>2013</u>	<u>2012</u>
Auto lending	73,417	28,609
Small business lending	60,596	18,602
Corporate lending	40,213	23,025
Consumer lending	14,120	3,623
<b>Gross loans to customers</b>	<b><u>188,346</u></b>	<b><u>73,859</u></b>
Less: allowance for impairment	(4,233)	(1,789)
<b>Loans to customers</b>	<b><u>184,113</u></b>	<b><u>72,070</u></b>

In accordance with the Bank's internal classification, individual entrepreneurs with annual turnover above certain threshold established by management are also included in the corporate lending portfolio of the Bank.

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)***(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)***7. Loans to customers (continued)****Allowance for impairment of loans to customers**

The movement in allowance for impairment losses on loans to customers by class of loan is as follows:

	<b>Auto lending 2013</b>	<b>Corporate lending 2013</b>	<b>Small business lending 2013</b>	<b>Consumer lending 2013</b>	<b>Total 2013</b>
At 1 January 2013	370	1,254	118	47	1,789
Charge for the year	1,124	69	529	722	2,444
<b>At 31 December 2013</b>	<b>1,494</b>	<b>1,323</b>	<b>647</b>	<b>769</b>	<b>4,233</b>
Individual impairment	52	625	635	-	1,312
Collective impairment	1,442	698	12	769	2,921
	<u>1,494</u>	<u>1,323</u>	<u>647</u>	<u>769</u>	<u>4,233</u>
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	<u>52</u>	<u>908</u>	<u>1,676</u>	<u>-</u>	<u>2,636</u>

	<b>Auto lending 2012</b>	<b>Corporate lending 2012</b>	<b>Small business lending 2012</b>	<b>Consumer lending 2012</b>	<b>Total 2012</b>
At 1 January 2012	183	296	819	28	1,326
Charge for the year / (reversal)	187	958	(701)	19	463
<b>At 31 December 2012</b>	<b>370</b>	<b>1,254</b>	<b>118</b>	<b>47</b>	<b>1,789</b>
Individual impairment	176	498	115	-	789
Collective impairment	194	756	3	47	1,000
	<u>370</u>	<u>1,254</u>	<u>118</u>	<u>47</u>	<u>1,789</u>
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	<u>264</u>	<u>871</u>	<u>439</u>	<u>-</u>	<u>1,574</u>

**Individually impaired loans**

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2013, comprised AZN 118 (2012 - AZN 370).

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

**Collateral and other credit enhancements**

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

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)**

*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*

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**7. Loans to customers (continued)****Collateral and other credit enhancements (continued)**

The main types of collateral obtained are as follows:

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

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

**Concentration of loans to customers**

As of 31 December 2013, the Bank had a concentration of loans represented by AZN 26,972 due from the ten (2012 - ten) largest third party borrowers (14% of gross loan portfolio) (2012 - AZN 20,114 or 27% of gross loan portfolio). An allowance of AZN 1,322 (2012 - AZN 622) was recognized against these loans.

Loans are made principally within Azerbaijan in the following industry sectors:

	<b>2013</b>	<b>2012</b>
Individuals	97,013	32,232
Trading enterprises	27,874	19,320
Services	20,391	4,518
Transport	10,272	2,492
Other	15,093	1,998
Manufacturing	10,115	4,994
Agriculture and food processing	4,988	4,955
Credit institutions, other than banks	1,479	1,860
Energy	1,121	1,490
Gross loans to customers	<b>188,346</b>	<b>73,859</b>

**Bank VTB (Azerbaijan) OJSC**
**Notes to the financial statements (continued)**
*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*
**8. Property and equipment**

The movements in property and equipment were as follows:

	<i>Leasehold improvements</i>	<i>Computer equipment</i>	<i>Furniture and fixtures</i>	<i>Motor vehicles</i>	<i>Other property and equipment</i>	<i>Total</i>
<b>Cost</b>						
31 December 2011	911	809	601	345	90	2,756
Additions	76	138	60	-	32	306
31 December 2012	987	947	661	345	122	3,062
Additions	760	521	347	17	52	1,697
Disposals	(751)	-	-	-	-	(751)
31 December 2013	996	1,468	1,008	362	174	4,008
<b>Accumulated depreciation</b>						
31 December 2011	(509)	(400)	(243)	(224)	(35)	(1,411)
Depreciation charge	(293)	(202)	(147)	(56)	(21)	(719)
31 December 2012	(802)	(602)	(390)	(280)	(56)	(2,130)
Disposals	751	-	-	-	-	751
Depreciation charge	(212)	(274)	(185)	(50)	(29)	(750)
31 December 2013	(263)	(876)	(575)	(330)	(85)	(2,129)
<b>Net book value:</b>						
31 December 2011	402	409	358	121	55	1,345
31 December 2012	185	345	271	65	66	932
31 December 2013	733	592	433	32	89	1,879

**9. Intangible assets**

	<i>Licenses</i>	<i>Computer Software</i>	<i>Total</i>
<b>Cost</b>			
31 December 2011	551	430	981
Additions	104	385	489
31 December 2012	655	815	1,470
Additions	110	91	201
31 December 2013	765	906	1,671
<b>Accumulated amortization</b>			
31 December 2011	(46)	(102)	(148)
Amortization charge	(68)	(50)	(118)
31 December 2012	(114)	(152)	(266)
Amortization charge	(72)	(110)	(182)
31 December 2013	(186)	(262)	(448)
<b>Net book value:</b>			
31 December 2011	505	328	833
31 December 2012	541	663	1,204
31 December 2013	579	644	1,223



**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)***(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)***10. Taxation**

Azerbaijan legal entities have to file individual corporate income tax declarations. Standard corporate income tax rate for companies (including banks) comprised 20% for 2013 and 2012.

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

	<b>2013</b>	<b>2012</b>
<b>Profit / (Loss) before tax</b>	<b>3,397</b>	<b>(2,293)</b>
Statutory tax rate	20%	20%
<b>Theoretical income tax charge / (benefit) at the statutory rate</b>	<b>(679)</b>	<b>459</b>
Tax effect of permanent differences	(301)	23
Change in unrecognized deferred tax assets	-	(482)
Utilized tax losses carried forward, not recognized previously	2,099	-
Other	25	-
<b>Income tax benefit</b>	<b>1,144</b>	<b>-</b>

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

	<b>2011</b>	<b>Origination and reversal of temporary differences in statement of comprehensive income</b>	<b>2012</b>	<b>Origination and reversal of temporary differences in statement of comprehensive income</b>	<b>2013</b>
<b>Tax effect of deductible temporary differences:</b>					
Property and equipment	(8)	36	28	(28)	-
Other liabilities	67	(50)	17	99	116
Tax losses carried forward	1,560	539	2,099	(755)	1,344
<b>Deferred tax assets</b>	<b>1,619</b>	<b>525</b>	<b>2,144</b>	<b>(684)</b>	<b>1,460</b>
Loan to customers	(144)	(13)	(157)	(113)	(270)
Intangible assets	(1)	(15)	(16)	2	(14)
Other assets	-	(7)	(7)	(5)	(12)
Due from credit institutions	-	(22)	(22)	2	(20)
<b>Deferred tax liabilities</b>	<b>(145)</b>	<b>(57)</b>	<b>(202)</b>	<b>(114)</b>	<b>(316)</b>
<b>Net deferred income tax assets / (liabilities)</b>	<b>1,474</b>	<b>468</b>	<b>1,942</b>	<b>(798)</b>	<b>1,144</b>
Unrecognized deferred tax asset	(1,474)	(468)	(1,942)	1,942	-
<b>Net deferred tax asset</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,144</b>	<b>1,144</b>

The Bank expects to generate sufficient taxable income within next several years to completely utilize deferred income tax assets derived from tax losses carried forward.

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)***(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)***11. Other assets and liabilities**

Other assets comprise:

	<b>2013</b>	<b>2012</b>
Amounts in the course of settlement	15	13
Agency fees receivables	87	64
<b>Total other financial assets</b>	<b>102</b>	<b>77</b>

Prepayment for purchase of property, equipment and intangible assets	159	512
Other prepayments	133	69
Other non-financial assets	65	48
<b>Total other non-financial assets</b>	<b>357</b>	<b>629</b>

<b>Other assets</b>	<b>459</b>	<b>706</b>
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Other liabilities comprise:

	<b>2013</b>	<b>2012</b>
Payable for professional services	55	31
Other financial liabilities	10	37
<b>Total other financial liabilities</b>	<b>65</b>	<b>68</b>

Payable to employees	468	87
Taxes payable, other than income tax	115	21
Other non-financial liabilities	117	2
<b>Total other non-financial liabilities</b>	<b>700</b>	<b>110</b>

<b>Other liabilities</b>	<b>765</b>	<b>178</b>
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**12. Amounts due to credit institutions**

Amounts due to credit institutions comprise:

	<b>2013</b>	<b>2012</b>
Current accounts	88	82
Short term loans from banks	18,285	19,886
Long term loans from banks	108,181	33,771
<b>Amounts due to credit institutions</b>	<b>126,554</b>	<b>53,739</b>

Included in current accounts is a balance of AZN 79 (2012 - AZN 79) with "Bank VTB" OJSC (the "Parent").

As of 31 December 2013, the Bank had short term loan borrowings from the Parent and one non-resident bank with total principal amount of AZN 10,102 (2012- AZN 8,915) and AZN 7,845 (2012- AZN 10,971), respectively. Borrowings are denominated in USD with average annual interest rate of 3.7% p.a. (2012 - 5.3% p.a.) and 4.5% p.a. (2012 - 5,7 %), respectively.

At 31 December 2013, the Bank had long term borrowings from the Parent and one non-resident bank with total principal amount of AZN 101,354 (2012 - AZN 27,936) and AZN 5,492 (2012- AZN 5,835), respectively. Borrowings are denominated in USD with average annual interest rate of 5.2% (2012 - 6.4%) and 7% (2012 - 7%), respectively. Borrowings are maturing in 2014-2017 years.

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)**

*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*

**13. Amounts due to customers**

Amounts due to customers include the following:

	<b>2013</b>	<b>2012</b>
Current accounts	17,283	3,377
Time deposits	13,967	10,983
<b>Amounts due to customers</b>	<b>31,250</b>	<b>14,360</b>
Held as security against guarantees	-	20

At 31 December 2013, customer accounts of AZN 19,677 or 63% (2012- AZN 9,740 or 68%) were due to the ten (2012- ten) largest customers.

The average annual interest rate on term deposits of individual customers outstanding at 31 December 2013 comprised 8.5% (2012- 9.5%), while the average annual interest rate on term deposits of legal entities outstanding at 31 December 2013 was 7.8% (2012- 8.6%).

An analysis of customer accounts by economic sector is as follows:

	<b>2013</b>	<b>2012</b>
Individuals	11,335	4,804
Service	9,950	617
Insurance	8,354	8,795
Credit institutions	1,426	-
Public organizations	91	53
Other	86	87
Trading	8	-
Construction	-	4
<b>Amounts due to customers</b>	<b>31,250</b>	<b>14,360</b>

**14. Subordinated debts**

As of 31 December 2013, the Bank had three (2012 - three) subordinated debts received from the Parent for principal amount of AZN 4,354 (2012 - AZN 4,357) with interest rate of 7.16% - 9.84% p.a. (2012 - 7.16% - 9.84%) and maturing in August 2018 and December 2018 (2012 - August 2018 and December 2018).

Interest payables on debts are on quarterly basis and the principal payables are on the maturity dates. In the event of bankruptcy or liquidation of the Bank's repayments of this debt is subordinated to repayment of the Bank's liabilities all other creditors.

**15. Equity**

As of 31 December 2013 and 2012 the number of authorized, issued and fully paid ordinary shares was 254,075,000 and 119,075,000, respectively with a nominal value per share of AZN 0.2.

On 13 August 2013, the shareholders of the Bank increased the share capital of the Bank by additional cash contribution amounting of AZN 13,770 thousands. Increase was carried out by issuing of 68,850,000 authorized shares with par value of AZN 0.2.

On 15 November 2013, the shareholders of the Bank increased the share capital of the Bank by additional cash contribution amounting of AZN 13,230 thousands. Increase was carried out by issuing of 66,149,993 authorized shares with par value of AZN 0.2.

## **Bank VTB (Azerbaijan) OJSC**

### **Notes to the financial statements (continued)**

*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*

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#### **15. Equity (continued)**

In accordance with Azerbaijan legislation, the shareholders of the Bank should have the following rights: elect and be elected to its management and executive bodies, collect information related to the activity of the Bank, familiarize with annual reports and accounts once a year, request holding the General Meeting of Shareholders, request amendments to the agenda of the General Meeting of Shareholders of the Bank, request audit of the activity of the Bank and in case of termination of Bank's activity, receive a distribution of Bank's assets remained after settlements with creditors and payment of calculated but unpaid dividends.

#### **16. Commitments and contingencies**

##### *Operating environment*

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

The ongoing global financial crisis impacted certain industries significantly and has resulted in capital markets instability, deterioration of liquidity in the banking sector, and tighter credit conditions within the Azerbaijan Republic. The Azerbaijani Government has introduced a range of stabilization measures aimed at ensuring solvency and providing liquidity and supporting refinancing of foreign debt for Azerbaijan banks and companies.

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

##### *Legal*

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

##### *Taxation*

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. Recent events within the Republic of Azerbaijan suggest that the tax authorities may be taking a more assertive position in their interpretation and application of this legislation and assessments. It is therefore possible that transactions and activities of the Bank that have not been challenged in the past may be challenged at any time in the future. As a result, significant additional taxes, penalties and interest may be assessed by the relevant authorities. Fiscal periods remain open and subject to review by the tax authorities for a period of three calendar years immediately preceding the year in which the decision to conduct a tax review is taken. The last tax audit of the Bank was completed in 2010 and covered the period from 2008 to 2010.

Management believes that as of 31 December 2013 its interpretation of the relevant legislation is appropriate and that the Bank's tax positions will be sustained.

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)***(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)***16. Commitments and contingencies (continued)***Commitments and contingencies*

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

	<b>2013</b>	<b>2012</b>
<b>Credit related commitments</b>		
Guarantees	2,570	1,040
Letters of credit	374	-
Undrawn loan commitments	10,839	4,129
	<b>13,783</b>	<b>5,169</b>
<b>Operating lease commitments</b>		
Not later than 1 year	1,149	570
Later than 1 year but not later than 5 years	925	805
	<b>2,074</b>	<b>1,375</b>
Capital expenditure commitments	258	130
<b>Commitments and contingencies (before deducting collateral)</b>	<b>16,115</b>	<b>6,674</b>
Less: provisions	(44)	-
Less: cash held as security against guarantees (Note 13)	-	(20)
<b>Commitments and contingencies</b>	<b>16,071</b>	<b>6,654</b>

**17. Net interest income**

Net interest income comprises:

	<b>2013</b>	<b>2012</b>
Interest income on loans to customers	20,023	6,888
Interest income on due from credit institutions	241	646
<b>Interest income on financial assets recorded at amortized cost</b>	<b>20,264</b>	<b>7,534</b>
Other interest income	-	6
Interest income on other financial assets and transactions	-	6
<b>Interest income</b>	<b>20,264</b>	<b>7,540</b>
Interest expense on due to credit institutions	(4,830)	(1,935)
Interest expense on customer accounts	(887)	(471)
<b>Interest expense on financial liabilities recorded at amortized cost</b>	<b>(5,717)</b>	<b>(2,406)</b>
<b>Net interest income</b>	<b>14,547</b>	<b>5,134</b>

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)***(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)***18. Fee and commission income and expense**

Fee and commission income and expense comprises:

	<b>2013</b>	<b>2012</b>
Cash operations	605	262
Consulting and expert services	-	212
Documentary operations	117	62
Settlements operations	60	38
Plastic card operations	106	32
Other	62	23
<b>Fee and commission income</b>	<b>950</b>	<b>629</b>
Plastic card operations	(81)	(64)
Communication operations	(4)	(49)
Cash operations	(46)	(29)
Settlements operations	(16)	(11)
Documentary operations	(34)	(10)
Securities operations	(3)	-
<b>Fee and commission expense</b>	<b>(184)</b>	<b>(163)</b>
<b>Net fee and commission income</b>	<b>766</b>	<b>466</b>

**19. Operating expenses**

Operating expenses comprise:

	<b>2013</b>	<b>2012</b>
Salaries and bonuses	(5,507)	(3,136)
Social security costs	(1,219)	(678)
Other employment taxes	(163)	(126)
<b>Personnel expenses</b>	<b>(6,889)</b>	<b>(3,940)</b>
Depreciation and amortization	(932)	(837)
Occupancy and rent	(893)	(1,137)
Repair and maintenance of property and equipment	(96)	(65)
Communications	(215)	(137)
Marketing and advertising	(182)	(53)
Office supplies	(137)	(51)
Business travel and related	(122)	(82)
Representation	(122)	(123)
Legal and consultancy	(106)	(102)
Operating taxes	(90)	(27)
Security	(89)	(45)
Software cost	(189)	(139)
Utilities	(21)	(10)
Other expenses	(150)	(65)
<b>Other operating expenses</b>	<b>(3,344)</b>	<b>(2,873)</b>
<b>Total operating expenses</b>	<b>(10,233)</b>	<b>(6,813)</b>

## **20. Risk management**

### **Introduction**

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

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

#### *Risk management structure*

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

#### *Board of Directors*

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

#### *Management Board*

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

#### *Risk Committee*

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

#### *Risk Management*

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

#### *Risk Controlling*

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

#### *Bank Treasury*

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

## **20. Risk management (continued)**

### **Introduction (continued)**

#### *Internal audit*

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

#### *Risk measurement and reporting systems*

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

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

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

#### *Excessive risk concentration*

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

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

### **Credit risk**

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

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

#### *Credit-related commitments risks*

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



**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)***(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)***20. Risk management (continued)****Credit risk (continued)***Credit-related commitments risks (continued)*

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

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

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 7.

*Credit quality per class of financial assets*

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

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

	Notes	<i>Neither past due nor impaired</i>			<i>Past due but not impaired</i>	<i>Individually impaired</i>	<i>Total</i>
		<i>High grade</i>	<i>Standard grade</i>	<i>Sub-standard grade</i>			
		2013	2013	2013	2013	2013	2013
Due from credit institutions	6	-	5,029	-	-	888	5,917
Loans to customers Auto lending	7	-	66,431	17	6,917	53	73,418
Corporate lending		9,362	23,629	4,592	1,723	907	40,213
Small business lending		16,706	36,900	4,567	746	1,676	60,596
Consumer lending		4,293	900	7,512	1,415	-	14,120
<b>Total gross balances</b>		<b>30,361</b>	<b>132,889</b>	<b>16,688</b>	<b>10,801</b>	<b>3,524</b>	<b>194,263</b>

	Notes	<i>Neither past due nor impaired</i>			<i>Past due but not impaired</i>	<i>Individually impaired</i>	<i>Total</i>
		<i>High grade</i>	<i>Standard grade</i>	<i>Sub-standard grade</i>			
		2012	2012	2012	2012	2012	2012
Due from credit institutions	6	-	3,716	-	-	981	4,967
Loans to customers Auto lending	7	-	26,814	-	1,531	264	28,609
Corporate lending		-	21,737	-	417	871	23,025
Small business lending		-	17,585	313	265	439	18,602
Consumer lending		-	3,292	-	331	-	3,623
<b>Total gross balances</b>		<b>-</b>	<b>73,144</b>	<b>313</b>	<b>2,544</b>	<b>2,555</b>	<b>78,556</b>

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)***(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)***20. Risk management (continued)****Credit risk (continued)***Credit quality per class of financial assets (continued)*

Past due loans to customers include those that are only past due by a few days. An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

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

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

Loans to customer:

	<b>Less than 30 days 2013</b>	<b>31 to 60 days 2013</b>	<b>61 to 90 days 2013</b>	<b>More than 90 days 2013</b>	<b>Total 2013</b>
Auto lending	3,518	1,115	617	1,667	<b>6,917</b>
Corporate lending	353	-	1,370	-	<b>1,723</b>
Small business lending	203	133	393	17	<b>746</b>
Consumer lending	552	63	115	685	<b>1,415</b>
<b>Total</b>	<b>4,626</b>	<b>1,311</b>	<b>2,495</b>	<b>2,369</b>	<b>10,801</b>

	<b>Less than 30 days 2012</b>	<b>31 to 60 days 2012</b>	<b>61 to 90 days 2012</b>	<b>More than 90 days 2012</b>	<b>Total 2012</b>
Auto lending	889	242	134	266	<b>1,531</b>
Corporate lending	-	417	-	-	<b>417</b>
Small business lending	233	5	-	27	<b>265</b>
Consumer lending	115	40	48	128	<b>331</b>
<b>Total</b>	<b>1,237</b>	<b>704</b>	<b>182</b>	<b>421</b>	<b>2,544</b>

See Note 7 for more detailed information with respect to the allowance for impairment of loans to customers.

*Impairment assessment*

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

*Individually assessed allowances*

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

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)***(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)***20. Risk management (continued)****Credit risk (continued)***Collectively assessed allowances*

Allowances are assessed collectively for losses on loans to customers that are not individually significant and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the appropriate delay between the time a loss is likely to have been uncured and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. The impairment allowance is reviewed by credit management to ensure alignment with the Bank's overall policy.

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

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

	2013				2012			
	Azerbaijan	OECD	CIS and other foreign banks	Total	Azerbaijan	OECD	CIS and other foreign banks	Total
<b>Assets</b>								
Cash and cash equivalents	3,055	2,409	3,813	9,277	4,329	566	634	5,529
Mandatory reserve with the CBAR	4,197	-	-	4,197	1,336	-	-	1,336
Amounts due from credit institutions	5,009	20	-	5,029	3,696	20	-	3,716
Loans to customers	184,113	-	-	184,113	72,070	-	-	72,070
Other assets	92	10	-	102	65	12	-	77
	<b>196,466</b>	<b>2,439</b>	<b>3,813</b>	<b>202,718</b>	<b>81,496</b>	<b>598</b>	<b>634</b>	<b>82,728</b>
<b>Liabilities</b>								
Amounts due to credit institutions	(9)	-	(126,545)	(126,554)	(2)	-	(53,737)	(53,739)
Amounts due to customers	(31,250)	-	-	(31,250)	(14,360)	-	-	(14,360)
Subordinated loans	-	-	(4,378)	(4,378)	-	-	(4,381)	(4,381)
Other liabilities	(59)	(2)	(4)	(65)	(68)	-	-	(68)
	<b>(31,318)</b>	<b>(2)</b>	<b>(130,927)</b>	<b>(162,247)</b>	<b>(14,430)</b>	<b>-</b>	<b>(58,118)</b>	<b>(72,748)</b>
<b>Net assets/(liabilities)</b>	<b>165,148</b>	<b>2,437</b>	<b>(127,114)</b>	<b>40,471</b>	<b>67,066</b>	<b>598</b>	<b>(57,484)</b>	<b>10,180</b>

**Liquidity risk and funding management**

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed lines of credit that it can assess to meet liquidity needs. In addition, the Bank maintains a cash deposit (obligatory reserve) with the CBAR, the amount of which depends on the level of customer funds attracted.

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)***(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)***20. Risk management (continued)****Liquidity risk and funding management (continued)**

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratios established by the CBAR. As of 31 December, these ratios were as follows:

	<b>2013</b>	<b>2012</b>
Instant Liquidity Ratio	95%	178.9%

*Analysis of financial liabilities by remaining contractual maturities*

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

**Financial liabilities**

As of 31 December 2013

	<b>Less than 3 months</b>	<b>3 to 12 months</b>	<b>1 to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>
Due to credit institutions	8,824	29,143	102,596	-	140,563
Customer accounts	18,935	12,873	53	-	31,861
Other liabilities	65	-	-	-	65
Subordinated loans	100	306	5,933	-	6,339
<b>Total undiscounted financial liabilities</b>	<b>27,924</b>	<b>42,322</b>	<b>108,582</b>	<b>-</b>	<b>178,828</b>

**Financial liabilities**

As of 31 December 2012

	<b>Less than 3 months</b>	<b>3 to 12 months</b>	<b>1 to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>
Due to credit institutions	10,396	11,649	36,898	-	58,943
Customer accounts	5,024	9,373	508	-	14,905
Other liabilities	68	-	-	-	68
Subordinated loans	100	307	1,629	4,715	6,751
<b>Total undiscounted financial liabilities</b>	<b>15,588</b>	<b>21,329</b>	<b>39,035</b>	<b>4,715</b>	<b>80,667</b>

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

	<b>Less than 3 months</b>	<b>3 to 12 months</b>	<b>1 to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>
2013	1,061	2,330	10,392	-	13,783
2012	392	831	3,946	-	5,169

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

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)**

*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*

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**20. Risk management (continued)****Liquidity risk and funding management (continued)**

*Analysis of financial liabilities by remaining contractual maturities (continued)*

The Bank's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant concentration as of 31 December 2013 of deposits from individuals and service companies that represents about 68% of total portfolio (2012-37%) in the period less than one year.

As of 31 December 2013 the Bank has significant financing from the Parent totaling AZN 111,455 (2012- AZN 41,311). Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank. Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than three months in the tables above.

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

**Market risk**

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates and foreign exchanges. The Bank classifies exposures to market risk into non- trading portfolios. Non-trading positions are managed and monitored using sensitivity analysis. Except for the concentrations within foreign currency, the Bank has no significant concentration of market risk.

*Currency risk*

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Management Board has set limits on positions by currency based on the CBAR regulations. Positions are monitored on a daily basis.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2013 and 2012 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Manat, with all other variables held constant on the statement of comprehensive income (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on equity does not differ from the effect on the statement of comprehensive income. A negative amount in the table reflects a potential net reduction in statement of comprehensive income or equity, while a positive amount reflects a net potential increase.

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)**

(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

**20. Risk management (continued)****Market risk (continued)***Currency risk (continued)*

<b>Currency</b>	<b>Increase in currency rate in % 2013</b>	<b>Effect on profit before tax 2013</b>	<b>Increase in currency rate in % 2012</b>	<b>Effect on profit before tax 2012</b>
USD	1.37	1	3.82	7
EUR	10.16	8	11.49	10
RUR	22.29	99	20.97	2

  

<b>Currency</b>	<b>Decrease in currency rate in % 2013</b>	<b>Effect on profit before tax 2013</b>	<b>Decrease in currency rate in % 2012</b>	<b>Effect on profit before tax 2012</b>
USD	(1.37)	(1)	(3.82)	(7)
EUR	(10.16)	(8)	(11.49)	(10)
RUR	(22.29)	(99)	(20.97)	(2)

**Operational risk**

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

The Bank believes the amounts presented as financial assets and liabilities in the financial statements are reasonable estimates of their fair values. The fair value of cash and cash equivalents, amounts due and from credit institutions, loans to customers and other monetary current assets and liabilities is estimated to approximate carrying value due to their short-term nature. The carrying value of the borrowings from related and third parties approximates their fair values as their interest rates under these borrowings are close to the market indices. As of 31 December 2013 and 2012 amount of such borrowings were not materially different from their calculated fair values.

**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)***(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)***21. Maturity analysis of assets and liabilities**

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 20 "Risk management" for the Bank's contractual undiscounted repayment obligations and how management addresses the negative maturity mismatch below for within one year.

	<i>Within one Year</i>	<i>More than one year</i>	<i>Total</i>	<i>Within one year</i>	<i>More than one year</i>	<i>Total</i>
	<b>2013</b>	<b>2013</b>	<b>2013</b>	<b>2012</b>	<b>2012</b>	<b>2012</b>
Cash and cash equivalents	9,277	-	9,277	5,529	-	5,529
Mandatory reserves with CBAR	4,197	-	4,197	1,336	-	1,336
Due from credit institutions	5,029	-	5,029	3,716	-	3,716
Loans to customers	73,455	110,658	184,113	4,902	67,168	72,070
Property and equipment	-	1,879	1,879	-	932	932
Intangible assets	-	1,223	1,223	-	1,204	1,204
Other assets	459	-	459	706	-	706
<b>Total</b>	<b>92,417</b>	<b>113,760</b>	<b>206,177</b>	<b>16,189</b>	<b>69,304</b>	<b>85,493</b>
Due to credit institutions	19,886	106,668	126,554	19,968	33,771	53,739
Customer accounts	31,205	45	31,250	13,858	502	14,360
Other liabilities	765	-	765	178	-	178
Subordinated debts	24	4,354	4,378	-	4,381	4,381
<b>Total</b>	<b>51,880</b>	<b>111,067</b>	<b>162,947</b>	<b>34,004</b>	<b>38,654</b>	<b>72,658</b>
<b>Net</b>	<b>40,537</b>	<b>2,693</b>	<b>43,230</b>	<b>(17,815)</b>	<b>30,650</b>	<b>12,835</b>

**22. Related party disclosures**

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

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

As of 31 December 2013, the Bank had short term and long term loan borrowings from the Parent with total principal amount of AZN 10,102 (2012 - AZN 8,915) and AZN 101,353 (2012- AZN 27,936), respectively. Borrowings are denominated in USD with average annual interest rate of 3.7% p.a. (2012 - 5.3% p.a.) and 5.2% (2012 - 6.4%), respectively.

As of 31 December 2013, the Bank had outstanding deposits from entities under common control with total principal amount of AZN 1,500 (2012- AZN 1,205) and average annual interest rate of 7% p.a. (2012 - 9% p.a.).

**Bank VTB (Azerbaijan) OJSC**
**Notes to the financial statements (continued)**
*(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)*
**22. Related party disclosures (continued)**

The outstanding balances of related party transactions are as follows:

	2013			2012		
	Parent	Entities under common control		Parent	Entities under common control	
		Other related parties	Other related parties		Other related parties	
Loans outstanding at 1 January, gross	-	-	-	-	-	24
Loans issued during the year	-	-	257	-	-	-
Loan repayments during the year	-	-	(57)	-	-	(24)
Other movements	-	-	1	-	-	-
<b>Loans outstanding at 31 December, gross</b>	-	-	<b>201</b>	-	-	-
Deposits at 1 January	-	1,205	-	-	990	8
Deposits received during the year	-	1,500	355	-	215	-
Deposits repaid during the year	-	(1,205)	(59)	-	-	(8)
Other movements	-	8	5	-	-	-
<b>Deposits at 31 December</b>	-	<b>1,508</b>	<b>301</b>	-	<b>1,205</b>	-
Current accounts at 31 December	-	73	57	-	5	-
Cash and cash equivalents	3,754	2,406	-	595	564	-
Due from credit institutions	-	20	-	-	20	-
Due to credit institutions	112,222	-	-	36,930	-	-
Subordinated debts	4,378	-	-	4,381	-	-
Commitments and guarantees issued	-	20	-	-	20	-

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

	For the year ended 31 December					
	2013			2012		
	Parent	Entities under common control	Other related parties	Parent	Entities under common control	Other related parties
Interest income	-	-	37	-	-	-
Interest expense	(3,736)	(56)	(7)	(1,172)	(101)	-
Fee and commission income	-	91	-	60	-	-
Other income	-	-	-	-	43	-
Fee and commission expense	(2)	-	-	(3)	(10)	-
Other operating expenses	-	(63)	-	(1)	(46)	-



**Bank VTB (Azerbaijan) OJSC****Notes to the financial statements (continued)***(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)***22. Related party disclosures (continued)**

Compensation of key management personnel was comprised of the following:

	<b>2013</b>	<b>2012</b>
Salaries and other short-term benefits	1,135	623
Social security costs	250	137
<b>Total key management personnel compensation</b>	<b>1,385</b>	<b>760</b>

**23. Capital adequacy**

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

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

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

Management believes that the Bank was in compliance with the statutory capital adequacy ratio throughout 2013 and 2012.

According to the CBAR board's decision dated 25 July 2012, the minimum total capital of existing banks and authorised capital of newly established banks increased from the current AZN 10,000 to AZN 50,000. The new requirement for the capitalisation of the existing banks will come into force from January 1, 2015.

At 31 December the Bank's capital adequacy ratios based on the CBAR requirements were as follows:

	<b>2013</b>	<b>2012</b>
Tier 1 capital	38,362	11,362
Tier 2 capital	8,320	5,432
Less: deductions from capital	(1,923)	(1,204)
<b>Total regulatory capital</b>	<b>44,759</b>	<b>15,590</b>
<b>Risk-weighted assets</b>	<b>211,279</b>	<b>85,986</b>
Tier 1 capital adequacy ratio	17.2%	11.8%
Total capital adequacy ratio	21.2%	18.1%

**24. Events after the reporting period**

During January 2014 the Bank attracted two-short term funds from the Parent in the amount of AZN 5,492. Borrowings are denominated in USD with average annual interest rate of 0.35% p.a.

In January and February 2014 the Bank repaid funds borrowed from the Parent and non-resident bank in the amount of AZN 6,036 and AZN 5,492 equivalent denominated in USD, respectively.