

**“BANK VTB (AZERBAIJAN)”
OPEN JOINT STOCK
COMPANY**

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

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

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

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

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

In preparing the financial statements, management is responsible for:

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

Management is also responsible for:

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

The financial statements for the year ended December 31, 2011 were authorized for issue on February 16, 2012 by the Management Board of the Bank.

On behalf of the Management Board:

Alexander Yeryomin
Chairman of the Management Board

February 16, 2012
Baku, the Republic of Azerbaijan

Ravilya Sharafetdinova
Chief Accountant

February 16, 2012
Baku, the Republic of Azerbaijan

INDEPENDENT AUDITORS' REPORT

To the Shareholders and the Board of Directors of "Bank VTB (Azerbaijan)" Open Joint Stock Company:

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

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

February 16, 2012
Baku, the Republic of Azerbaijan

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

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

	Notes	Year ended December 31, 2011	Year ended December 31, 2010
Interest income	5,26	4,721	2,928
Interest expense	5,26	<u>(1,171)</u>	<u>(1,061)</u>
Net interest income before provision for impairment losses on interest bearing assets		<u>3,550</u>	<u>1,867</u>
Provision for impairment losses on interest bearing assets	6	(1,333)	(1,493)
Net interest income		<u>2,217</u>	<u>374</u>
Net gain on foreign exchange operations	7	45	25
Fee and commission income	8,26	223	130
Fee and commission expense	8,26	(60)	(56)
Other income		<u>52</u>	<u>7</u>
Net non-interest income		<u>260</u>	<u>106</u>
Operating income		<u>2,477</u>	<u>480</u>
Operating expenses	9,26	<u>(5,563)</u>	<u>(4,551)</u>
Loss before income tax		<u>(3,086)</u>	<u>(4,071)</u>
Income tax benefit	10	<u>-</u>	<u>66</u>
Net loss for the year		<u>(3,086)</u>	<u>(4,005)</u>
TOTAL COMPREHENSIVE LOSS FOR THE YEAR		<u>(3,086)</u>	<u>(4,005)</u>
Loss per share			
Basic and diluted (AZN)	11	(0.026)	(0.034)

On behalf of the Management Board:

Alexander Yeryomin
Chairman of the Management Board

February 16, 2012
Baku, the Republic of Azerbaijan

Ravilya Sharafetdinova
Chief Accountant

February 16, 2012
Baku, the Republic of Azerbaijan

The notes on pages 9-56 form an integral part of these financial statements.

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

STATEMENT OF FINANCIAL POSITION

AS AT DECEMBER 31, 2011

(In thousands of Azerbaijani Manats)

	Notes	December 31, 2011	December 31, 2010
ASSETS			
Cash and cash equivalents	12	1,081	3,663
Mandatory reserves with the Central Bank of the Republic of Azerbaijan		773	10
Due from banks	13	485	5,418
Loans to customers	14,26	45,098	13,839
Available-for-sale investments	15	-	621
Held-to-maturity investments	16	-	947
Property and equipment	17	1,345	1,585
Intangible assets	18	833	386
Other assets	19	542	258
TOTAL ASSETS		50,157	26,727
LIABILITIES AND EQUITY			
LIABILITIES:			
Due to banks	20	26,902	1,211
Customer accounts	21,26	4,403	3,868
Subordinated debt	22,26	3,366	3,414
Other liabilities	23	358	20
Total liabilities		35,029	8,513
EQUITY:			
Share capital	24	23,815	23,815
Accumulated deficit		(8,687)	(5,601)
Total equity		15,128	18,214
TOTAL LIABILITIES AND EQUITY		50,157	26,727

On behalf of the Management Board:

Alexander Yeryomin
Chairman of the Management Board

February 16, 2012
 Baku, the Republic of Azerbaijan

Ravilya Sharafetdinova
Chief Accountant

February 16, 2012
 Baku, the Republic of Azerbaijan

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“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

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

	Share capital	Accumulated deficit	Total equity
December 31, 2009	23,815	(1,596)	22,219
Total comprehensive loss for the year	<u>-</u>	<u>(4,005)</u>	<u>(4,005)</u>
December 31, 2010	<u>23,815</u>	<u>(5,601)</u>	<u>18,214</u>
Total comprehensive loss for the year	<u>-</u>	<u>(3,086)</u>	<u>(3,086)</u>
December 31, 2011	<u>23,815</u>	<u>(8,687)</u>	<u>15,128</u>

On behalf of the Management Board:

Alexander Yeryomin
Chairman of the Management Board

February 16, 2012
Baku, the Republic of Azerbaijan

Ravilya Sharafetdinova
Chief Accountant

February 16, 2012
Baku, the Republic of Azerbaijan

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“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

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

	Notes	Year ended December 31, 2011	Year ended December 31, 2010
CASH FLOWS FROM OPERATING ACTIVITIES:			
Interest received		4,539	2,754
Interest paid		(1,130)	(1,007)
Fees and commissions received		223	130
Fees and commissions paid		(60)	(56)
Gain from trading in foreign currencies		48	25
Other operating income received		56	7
Personnel expenses paid		(2,685)	(2,405)
Other operating expenses paid		(1,846)	(1,657)
		<hr/>	<hr/>
Cash outflow from operating activities before changes in operating assets and liabilities		(855)	(2,209)
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Due from banks		4,837	2,805
Mandatory reserves with the Central Bank of the Republic of Azerbaijan		(763)	(6)
Loans to customers		(32,442)	(11,041)
Other assets		(36)	(9)
		<hr/>	<hr/>
Increase/(decrease) in operating liabilities:			
Due to banks		25,739	400
Customer accounts		631	(887)
Other liabilities		7	(95)
		<hr/>	<hr/>
Cash outflow from operating activities before taxation		(2,882)	(11,042)
Income tax paid		-	(11)
		<hr/>	<hr/>
Net cash outflow from operating activities		(2,882)	(11,053)
		<hr/>	<hr/>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Payment for property and equipment		(507)	(251)
Payment for intangible assets		(652)	(79)
Payment for/(proceeds from) available-for-sale investments		613	(2,017)
Proceeds from available-for-sale investments		-	1,400
Proceeds from held-to-maturity investments, net		850	2,149
		<hr/>	<hr/>
Net cash inflow from in investing activities		304	1,202
		<hr/>	<hr/>

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

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

Effect of foreign exchange rate changes on cash and cash equivalents		(4)	(11)
NET DECREASE IN CASH AND CASH EQUIVALENTS		(2,582)	(9,862)
CASH AND CASH EQUIVALENTS, <i>beginning of the year</i>	12	<u>3,663</u>	<u>13,525</u>
CASH AND CASH EQUIVALENTS, <i>end of the year</i>	12	<u><u>1,081</u></u>	<u><u>3,663</u></u>

On behalf of the Management Board:

Alexander Yeryomin
Chairman of the Management Board

February 16, 2012
Baku, the Republic of Azerbaijan

Ravilya Sharafetdinova
Chief Accountant

February 16, 2012
Baku, the Republic of Azerbaijan

The notes on pages 9-56 form an integral part of these financial statements.

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (In thousands of Azerbaijani Manats)

1. INTRODUCTION

Organization and its principal activity

“Bank VTB (Azerbaijan)” Open Joint Stock Company (the “Bank”) was established in the Republic of Azerbaijan in 1993, formerly registered as “AF-Bank” OJSC on December 14, 1993.

The Bank is regulated by the Central Bank of the Republic of Azerbaijan (the “CBRA”) and conducts its business under license number 162 issued by the CBRA on October 22, 1993.

The Bank’s primary business consists of trading with securities and foreign currencies, originating loans and guarantees and other banking related commercial activities.

“AF-Bank” OJSC, formerly “Continent Bank” Joint Stock Company, was registered on September 22, 1993 by the CBRA and started its activities under the name “AF Bank” since March 11, 2003 and was registered at the Ministry of Justice in June 2003. “AF-Bank” was an open joint-stock company since May 18, 2005.

On October 27, 2007 two companies registered in Cyprus (Balmwell Limited LLC (49.99%) and Nies Ventures Limited LLC (49.99%) acquired 99.8% of the Bank from its former shareholders.

On July 31, 2008, “Bank VTB” OJSC (Russian Federation) signed an agreement to purchase 390,751 shares owned by Balmwell Limited LLC, (1.000003% of total shares of the Bank) and 19,537,499 shares owned by Nies Ventures Limited LLC (49.999997% of total shares of the Bank) and accordingly to obtain controlling share of 51% of the Bank.

The acquisition was approved by the CBRA and the State Antimonopoly Committee operating under the Ministry of Economic Development of the Republic of Azerbaijan on October 31, 2008 and December 2, 2008, respectively. Subsequently, on February 24, 2009 the Bank was renamed into “Bank VTB (Azerbaijan)”, the registration process was confirmed by the Ministry of Taxes (Extraction from the State Register of Commercial Legal Entities dated February 24, 2009).

On November 9, 2009, “AtaHolding” OJSC acquired 48.99% of the Bank from its former shareholders of Balmwell Limited LLC.

As at December 31, 2011 the Bank had one branch.

Registered address and place of business:

The address of Bank’s registered office is 96 Nizami Street, Baku, the Republic of Azerbaijan.

Shareholders of the Bank

As at December 31, 2011 and 2010, the following entities and individuals owned the share capital of the Bank:

Shareholders	December 31, 2011, %	December 31, 2010, %
“Bank VTB” OJSC (Russian Federation)	51.00	51.00
“AtaHolding” OJSC	48.99	48.99
Kamilov Ashraf	0.01	0.01
Total	100%	100%

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) (In thousands of Azerbaijani Manats)

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).

Operating Environment of the Bank

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

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

2. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

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

Going concern

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

The Bank incurred a net loss of AZN 3,086 thousand and AZN 4,005 thousand during the years ended December 31, 2011 and 2010, respectively. Management has an intention to attract additional long term financing from “Bank VTB” OJSC (Russian Federation) which will allow the Bank to meet its operating cash flow plans. Management has prepared a detailed forecast of cash flows for 2012 and believes that future cash flows from operating and financing activities will be sufficient for the Bank to meet its obligations as they become due.

Other basis of presentation criteria

These financial statements are presented in thousands of Azerbaijani Manats (“AZN”), unless otherwise indicated. These financial statements have been prepared under the historical cost convention, as modified by initial recognition of financial instruments at fair value and the revaluation of available-for-sale financial assets.

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) *(In thousands of Azerbaijani Manats)*

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

The principal accounting policies are set out below:

Recognition of interest income and expense

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

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

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

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

Recognition of fee and commission income and expense

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

Financial instruments

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

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

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) (In thousands of Azerbaijani Manats)

Financial assets

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

Financial assets at FVTPL

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

Held-to-maturity investments

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

Loans and receivables

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

Gains and losses are recognized in profit and loss accounts when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Available-for-sale financial assets

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

Determination of fair value

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

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

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) *(In thousands of Azerbaijani Manats)*

Cash and cash equivalents

Cash and cash equivalents include cash on hand, unrestricted balances on correspondent and time deposit accounts with the CBRA and advances to other banks having original maturity up to 90 days.

Mandatory cash balances with the CBRA

Mandatory cash balances in AZN and foreign currencies held with the CBRA 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 purposes of the cash flow statement.

Due from banks

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

Loans to customers

Loans to customers are non-derivative assets with fixed or determinable payments that are not quoted in an active market, other than those classified in other categories of financial assets.

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

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit and loss accounts 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 investments categories only in rare circumstances.

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

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

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) *(In thousands of Azerbaijani Manats)*

Impairment of financial assets

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred “loss event”) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Assets carried at amortized cost

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

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

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

Available-for-sale investments

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

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognized in profit and loss accounts – is reclassified from other comprehensive income to profit and loss accounts. Impairment losses on equity investments are not reversed through profit and loss accounts; 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 amortized cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in profit and loss accounts. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit and loss accounts, the impairment loss is reversed through profit and loss accounts.

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) *(In thousands of Azerbaijani Manats)*

Renegotiated loans

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

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

Write off of loans and advances

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

Derecognition of financial assets

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

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

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

Financial liabilities and equity instruments

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

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Equity instruments

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

Financial liabilities

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

FVTPL

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

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

Other financial liabilities

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

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

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

Due to banks

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

Customer accounts

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

Subordinated debt

Subordinated debt includes long-term non-derivative liabilities and is carried at amortized cost. Debt is classified as subordinated debt when its repayment ranks after all other creditors in case of liquidation. Subordinated debt is included in “tier 2 capital” of the Bank.

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Financial guarantee contracts

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

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

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

Derecognition of financial liabilities

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

Offset of financial assets and liabilities

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

Leases

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

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

Property, equipment and intangible assets

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

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

Depreciation and amortization are charged on the carrying value of property, equipment and intangible assets and is designed to write off assets over their useful economic lives. The estimated useful lives, residual values and depreciation/amortization method are reviewed at the end of each

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reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following annual rates:

Leasehold improvements	33%
Computer equipments	25%
Furniture and fixtures	25%
Vehicles	25%
Other fixed assets	20%
Intangible assets	10%

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

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

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

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

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

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

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

Taxation

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

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

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

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

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

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

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

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

The management of the Bank provided valuation allowance in the amount of AZN 455 thousand against deferred tax assets as at December 31, 2011 (2010: AZN 684).

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

Provisions

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

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the

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present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

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

Retirement and other benefit obligations

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

Contingencies

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

Share capital

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

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

Foreign currency translation

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

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

Rates of exchange

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

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

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Operating Segments

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

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

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

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

Critical accounting judgements and key sources of estimation uncertainty

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

Allowance for impairment of loans

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

The Bank uses management’s judgment to estimate the amount of any impairment loss in cases where a borrower has financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on past performance, past customer behaviour, observable data indicating an adverse change in the payment status of borrowers in a group, and national or local economic conditions that correlate with

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defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans. The Bank uses management’s judgment to adjust observable data for a group of loans to reflect current circumstances not reflected in historical data.

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

The carrying amount of the allowance for impairment of loans to customers is AZN 2,826 thousand as at December 31, 2011 (2010: AZN 1,493 thousand).

Valuation of Financial Instruments

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

Where market-based valuation parameters are not directly observable, management will make a judgment as to its best estimate of that parameter in order to determine a reasonable reflection of how the market would be expected to price the instrument. In exercising this judgment, a variety of tools are used including proxy observable data, historical data, and extrapolation techniques.

The best evidence of fair value of a financial instrument at initial recognition is the transaction price unless the instrument is evidenced by comparison with data from observable markets. Any difference between the transaction price and the value based on a valuation technique is not recognized in the statement of comprehensive income on initial recognition. Subsequent gains or losses are only recognized to the extent that it arises from a change in a factor that market participants would consider in setting a price.

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

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

The carrying amount of the financial instruments at a fair value is as follows as at December 31, 2011 and 2010:

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	December 31, 2011	December 31, 2010
Available-for-sale investments	-	621

3. ADOPTION OF NEW AND REVISED STANDARDS

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

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

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

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

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

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

Amendments to IFRS 1 “First-time Adoption of International Financial Reporting Standards” (as part of Improvements to IFRS issued in 2010) – A first-time adopter that changes its accounting policies or its use of IFRS 1 exemptions after publishing a set of IAS 34 interim financial information should explain those changes and include the effects of such changes in its opening reconciliations within the first annual IFRS reporting. The exemption to use a “deemed cost” arising from a revaluation triggered by an event such as a privatization that occurred at or before the date of

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transition to IFRS is extended to revaluations that occur during the period covered by the first IFRS financial statements. Entities subject to rate regulation are allowed to use previous GAAP carrying amounts of property, plant and equipment or intangible assets as deemed cost on an item-by-item basis. Entities that use this exemption are required to test each item for impairment under IAS 36 at the date of transition.

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

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

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

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

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

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

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

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

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

4. STANDARDS AND INTERPRETATIONS ISSUED AND NOT YET ADOPTED

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

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

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

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

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

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

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

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

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

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

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

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

IFRS 13 “Fair Value Measurement” – IFRS 13 “Fair Value Measurement” defines fair value, sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value

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

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

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

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

5. NET INTEREST INCOME

	Year ended December 31, 2011	Year ended December 31, 2010
Interest income comprises:		
Interest income on financial assets recorded at amortized cost:		
- interest income on unimpaired assets	4,323	2,767
- interest income on impaired assets	357	1
Interest income on held-to-maturity investments	25	108
Other interest income	16	52
Total interest income	4,721	2,928
Interest income on financial assets recorded at amortized cost comprises:		
Interest income on loans to customers	4,261	1,689
Interest income on due from banks	419	1,079
Interest income on held-to-maturity investments	25	108
Total interest income on financial assets recorded at amortized cost	4,705	2,876
Other interest income	16	52
Total interest income on other financial assets and transactions	16	52
Total interest income	4,721	2,928
Interest expense comprises:		
Interest expense on financial liabilities recorded at amortized cost comprises of:		
Interest expense on customer accounts	(274)	(618)
Interest expense on due to banks	(897)	(443)
Total interest expense	(1,171)	(1,061)
Net interest income before provision for impairment losses on interest bearing financial assets	3,550	1,867

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6. ALLOWANCE FOR IMPAIRMENT LOSSES

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

	Loans to customers
December 31, 2009	-
Provision charge	(1,493)
December 31, 2010	(1,493)
Write-off of assets	1,500
Provision charge	(1,333)
December 31, 2011	(1,326)

7. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprises:

	Year ended December 31, 2011	Year ended December 31, 2010
Dealing differences, net	48	25
Translation differences, net	(3)	-
Total net gain on foreign exchange operations	45	25

8. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	Year ended December 31, 2011	Year ended December 31, 2010
Fee and commission income:		
Cash transactions	99	53
Advisory and expert services	52	11
Settlement transactions	34	40
Foreign exchange operations	22	19
Plastic card operations	11	3
Documentary transactions	1	3
Other	4	1
Total fee and commission income	223	130
Fee and commission expense:		
Communication transactions	(34)	(31)
Settlement transactions	(14)	(8)
Documentary transactions	(5)	(2)
Plastic card operations	(5)	(1)
Securities transactions	(1)	(14)
Cash transactions	(1)	-
Total fee and commission expense	(60)	(56)

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9. OPERATING EXPENSES

Operating expenses comprises:

	Year ended December 31, 2011	Year ended December 31, 2010
Salary and other employee benefits	(2,482)	(1,954)
Rent expenses	(1,079)	(923)
Depreciation and amortization	(730)	(638)
Social security costs	(540)	(426)
Advertising and marketing expenses	(130)	(141)
Software maintenance costs	(103)	(69)
Communication expenses	(82)	(42)
Professional services fees	(70)	(35)
Business trip expenses	(61)	(67)
Employee related other expenses	(51)	(42)
Representation expenses	(44)	(38)
Printing and office supplies	(37)	(36)
Taxes, other than income tax expense	(27)	(13)
Security expenses	(24)	(18)
Membership fees	(18)	(17)
Transportation costs	(15)	(17)
Staff trainings and financial assistance	(12)	(16)
Repairs and maintenance expenses	(11)	(10)
Insurance expenses	(7)	(6)
Utility expenses	(6)	(5)
Other expenses	(34)	(38)
	<u>(5,563)</u>	<u>(4,551)</u>
Total operating expenses	<u>(5,563)</u>	<u>(4,551)</u>

For the year ended December 31, 2011 the amount paid as termination benefit for cancelled employee contracts was nil (2010: USD 50 thousand).

10. INCOME TAXES

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

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

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

As at December 31, 2011 and December 31, 2010 the Bank made loss in the amount of AZN 3,086 and AZN 4,005 thousand, respectively and was not eligible to use benefit from these holidays.

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

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

	December 31, 2011	December 31, 2010
Taxable temporary differences:		
Loans to customers	(886)	(347)
Intangible assets	(41)	(22)
Property and equipment	(3)	(138)
Other liabilities	-	(63)
Available-for-sale investments	-	(4)
Held-to-maturity investments	-	(25)
Due from banks	-	(108)
	<u> </u>	<u> </u>
Total taxable temporary differences	(930)	(707)
Deductible temporary differences:		
Tax loss carried forward	6,760	4,127
	<u> </u>	<u> </u>
Total deductible temporary differences	6,760	4,127
Net deferred deductible temporary differences	5,830	3,420
Net deferred tax asset at the statutory tax rate of 20%	1,166	684
Deferred tax asset not recognized	(1,166)	(684)
Deferred tax asset	<u> </u>	<u> </u>

As at reporting date, the Bank has available AZN 6,670 thousand of accumulated tax losses carried forward which begin to expire during the next five years until 2016, if not utilized (2010: AZN 4,127 thousand of accumulated tax losses carried forward which begin to expire during the next five years until 2015).

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

	December 31, 2011	December 31, 2010
Loss before income tax	(3,086)	(4,071)
Statutory tax rate	20%	20%
Theoretical tax at the statutory tax rate (20%)	617	814
Tax effect of permanent differences	(162)	(64)
Deferred tax asset not recognized	(455)	(684)
	<u> </u>	<u> </u>
Income tax benefit	-	66
Current income tax expense	-	(11)
Deferred income tax benefit	-	77
	<u> </u>	<u> </u>
Income tax benefit	-	66

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	December 31, 2011	December 31, 2010
Deferred income tax asset/(liabilities):		
Beginning of the period	-	(77)
Deferred tax benefit	-	77
End of the period	-	-

11. LOSS PER SHARE

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

	Year ended December 31, 2011	Year ended December 31, 2010
Loss:		
Net loss for the year	3,086	4,005
Loss used in calculation of earnings per share	3,086	4,005
Weighted average number of ordinary shares for basic loss per share	119,075	119,075
Loss per share – basic and diluted (AZN)	0.026	0.034

12. CASH AND CASH EQUIVALENTS

Cash and cash equivalents for the year ended December 31, 2011 and 2010 comprises:

	December 31, 2011	December 31, 2010
Cash in hand	838	1,004
Balances with other banks	172	794
Balances with the CBRA	71	1,865
Total cash and cash equivalents	1,081	3,663

Currency, liquidity and geographical analysis of cash and cash equivalents are disclosed in Note 31.

13. DUE FROM BANKS

	December 31, 2011	December 31, 2010
Correspondent accounts with other banks	-	30
Loans to banks	485	5,388
Total due from banks	485	5,418

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) (In thousands of Azerbaijani Manats)

Included in due from banks is accrued interest income in the amount of AZN 3 and AZN 6 thousand as at December 31, 2011 and December 31, 2010 respectively.

As at December 31, 2011 maximum credit risk exposure of due from banks amounted to AZN 485 thousand (2010: AZN 5,418 thousand).

Currency, liquidity and geographical analysis of due from banks are disclosed in Note 31.

14. LOANS TO CUSTOMERS

	December 31, 2011	December 31, 2010
Originated loans	46,424	15,332
Less allowance for impairment losses	<u>(1,326)</u>	<u>(1,493)</u>
Total loans to customers, net	<u>45,098</u>	<u>13,839</u>

As at December 31, 2011 and 2010, accrued interest income included in loans to customers amounted to AZN 570 and AZN 118 thousand, respectively.

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

The table below summarizes the amount of loans secured by the type of collateral, rather than the fair value of collateral itself:

	December 31, 2011	December 31, 2010
Loans collateralized by bank guarantee	23,753	-
Loans collateralized by real estate	9,529	2,662
Loans collateralized by vehicles	9,021	3,273
Loans collateralized by inventories	1,083	6,773
Loans collateralized by securities	572	277
Loans collateralized by precious metals	-	9
Unsecured loans	<u>1,140</u>	<u>845</u>
Total loans to customers, net	<u>45,098</u>	<u>13,839</u>

Analysis by industry	December 31, 2011	December 31, 2010
Manufacturing	27,241	277
Individuals	10,701	7,374
Trading	4,646	5,264
Transportation	856	197
Catering	807	221
Telecommunication	550	-
Construction	<u>297</u>	<u>506</u>
Total loans to customers, net	<u>45,098</u>	<u>13,839</u>

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Loans to individuals comprise the following products:

	December 31, 2011	December 31, 2010
Car loans	8,233	3,146
Consumer loans	1,254	455
Entrepreneurship loans	1,214	3,773
Total loans to individuals, net	10,701	7,374

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

	Corporate Loans	Loans to individuals- car loans	Loans to individuals- entrepreneur- ship loans	Loans to individuals- consumer loans	Total
Unsecured loans	-	-	49	1,117	1,166
Loans collateralized by:					
- bank guarantee	23,753	-	-	-	23,753
- real estate	8,872	-	664	156	9,592
- vehicles	720	8,416	65	9	9,210
- inventories	1,094	-	61	-	1,155
- securities	354	-	1,194	-	1,548
Less: Allowance for loan impairment losses	(296)	(183)	(819)	(28)	(2,826)
Total loans to customers, net	34,397	8,233	1,214	1,254	45,098

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

	Corporate loans	Loans to individuals- car loans	Loans to individuals- entrepreneur- ship loans	Loans to individuals- consumer loans	Loans to individuals- mortgage loans	Total
Unsecured loans	709	-	-	156	-	865
Loans collateralized by:						
- real estate	1,919	-	1,344	158	-	3,421
- vehicles	116	3,146	-	10	-	3,272
- inventories	4,343	-	3,022	-	123	7,488
- securities	278	-	-	-	-	278
- precious metals	-	-	-	8	-	8
Less: Allowance for loan impairment losses	(900)	-	(593)	-	-	(1,493)
Total loans to customers, net	6,465	3,146	3,773	332	123	13,839

As at December 31, 2011 the Bank had one loan with total amount of AZN 26,741 which exceeded 25% of Bank's equity (see Note 29). This loan matures in the second quarter of 2012. But the management implies that the loan will be prolonged for one more year.

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

	Corporate Loans	Loans to individuals- car loans	Loans to individuals- consumer loans	Loans to individuals- entrepreneur- ship loans	Total
Unsecured loans	-	-	1,117	49	1,166
Loans collateralized by:					
- bank guarantee	23,753	-	-	-	23,753
- real estate	8,477	-	156	501	9,134
- vehicles	882	8,405	9	64	9,360
- inventories	1,016	-	-	61	1,077
- securities	186	-	-	-	186
Total current and not impaired loans	35,814	8,405	1,282	675	46,176
Loans individually determined to be impaired					
- 180 to 360 days overdue	379	11	-	1,358	1,748
Total individually impaired loans	379	11	-	1,358	1,748
Gross carrying value of total loans to customers	36,193	8,416	1,282	2,033	47,924
Less impairment provision	(296)	(183)	(28)	(819)	(2,826)
Total loans to customers, net	34,397	8,233	1,254	1,214	45,098

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

	Corporate Loans	Loans to individuals- car loans	Loans to individuals- consumer loans	Loans to individuals- entrepreneur- ship loans	Loans to individuals- mortgage loans	Total
Unsecured loans	709	-	156	-	-	865
Loans collateralized by:						
- inventories	4,343	-	-	2,035	-	6,378
- vehicles	116	3,146	10	-	-	3,272
- real estate	406	-	158	1,344	123	2,031
- securities	278	-	-	-	-	278
- precious metals	-	-	8	-	-	8
Total current and not impaired loans	5,852	3,146	332	3,379	123	12,832
Loans individually determined to be impaired						
- 180 to 360 days overdue	1,513	-	-	987	-	2,500
Total individually impaired loans	1,513	-	-	987	-	2,500
Gross carrying value of total loans to customers	7,365	3,146	332	4,366	123	15,332
Less impairment provision	(900)	-	-	(593)	-	(1,493)
Total loans to customers, net	6,465	3,146	332	3,773	123	13,839

Currency, liquidity and geographical analysis of loans to customers is disclosed in Note 31.

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15. AVAILABLE-FOR-SALE INVESTMENTS

As at December 31, 2011 the total amount of available-for-sale investment securities was equal to nil.

As at December 31, 2010 available-for-sale-investments included coupon bonds of Azerbaijan Mortgage Fund under the CBRA with face value of totalling AZN 617 thousand.

Currency, liquidity and geographical analysis of available-for-sale investments are disclosed in Note 31.

16. HELD-TO-MATURITY INVESTMENTS

As at December 31, 2011 the total amount of face value and accrued interest income in held-to-maturity investment securities was equal to nil.

As at December 31, 2010 held-to-maturity investments included coupon bonds with face value of AZN 850 thousand of the Ministry of Finance of the Republic of Azerbaijan with an interest rate of 14%.

As at December 31, 2010 accrued interest income included in these held-to-maturity investments amounted to AZN 97 thousand

Currency, liquidity and geographical analysis of held-to-maturity investments are disclosed in Note 31.

17. PROPERTY AND EQUIPMENT

As at December 31, 2011 and 2010, property and equipment balances comprise the following:

	Leasehold improve- ments	Computers equipment	Furniture and fixtures	Vehicles	Other fixed assets	Total
At initial cost						
December 31, 2009	751	696	394	215	73	2,129
Additions	-	69	51	130	3	253
Disposals	-	(36)	(7)	-	-	(43)
December 31, 2010	751	729	438	345	76	2,339
Additions	160	80	163	-	14	417
December 31, 2011	911	809	601	345	90	2,756
Accumulated depreciation						
December 31, 2009	-	(82)	(35)	(78)	(2)	(197)
Charge for the year	(250)	(168)	(102)	(64)	(16)	(600)
Disposals	-	36	7	-	-	43
December 31, 2010	(250)	(214)	(130)	(142)	(18)	(754)
Charge for the year	(259)	(186)	(113)	(82)	(17)	(657)
December 31, 2011	(509)	(400)	(243)	(224)	(35)	(1,411)

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	Leasehold improve- ments	Computers equipment	Furniture and fixtures	Vehicles	Other fixed assets	Total
Net book value						
December 31, 2011	<u>402</u>	<u>409</u>	<u>358</u>	<u>121</u>	<u>55</u>	<u>1,345</u>
December 31, 2010	<u>501</u>	<u>515</u>	<u>308</u>	<u>203</u>	<u>58</u>	<u>1,585</u>

18. INTANGIBLE ASSETS

As at December 31, 2011 and 2010, intangible assets comprise:

	Intangible Assets
At initial cost	
December 31, 2009	<u>382</u>
Additions	<u>79</u>
December 31, 2010	<u>461</u>
Additions	<u>520</u>
December 31, 2011	<u>981</u>
Accumulated amortization	
December 31, 2009	<u>(37)</u>
Charge for the year	<u>(38)</u>
December 31, 2010	<u>(75)</u>
Charge for the year	<u>(73)</u>
December 31, 2011	<u>(148)</u>
Net book value	
December 31, 2011	<u>833</u>
December 31, 2010	<u>386</u>

Intangible assets mainly include software and licences which are used in the operations of the Bank.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) (In thousands of Azerbaijani Manats)

19. OTHER ASSETS

	December 31, 2011	December 31, 2010
Other financial asset:		
Receivables on other transactions	43	9
Other non-financial assets:		
Prepayment for rent	226	230
Prepayments for purchase of property, equipment and intangible assets	222	-
Prepayment for insurance	9	6
Other	42	13
	<u>542</u>	<u>258</u>
Total other assets	<u>542</u>	<u>258</u>

20. DUE TO BANKS

	December 31, 2011	December 31, 2010
Borrowings from Parent	26,820	1,211
Loro accounts of other banks	82	-
	<u>26,902</u>	<u>1,211</u>
Total due to banks	<u>26,902</u>	<u>1,211</u>

As at December 31, 2011 the Bank had borrowings from “Bank VTB” OJSC (the “Parent”) for total principal amount of AZN 26,741 thousand in denominated amount of USD 34,000 thousand. These loans received are maturing on January 19, 2012, February 16, 2012, and April 23, 2012. They bear annual average interest rate of 3.5%. (2010: AZN 1,197 thousand with average interest rate of 5.12%).

As at December 31, 2011, accrued interest expense included in due to banks amounted to AZN 79 thousand (2010: AZN 14 thousand).

The management of the Bank is currently leading negotiations with the Parent for prolongation of these loans for an additional period of one year.

21. CUSTOMER ACCOUNTS

Customer accounts comprise:

	December 31, 2011	December 31, 2010
Term deposits	3,362	3,012
Repayable on demand	1,041	856
	<u>4,403</u>	<u>3,868</u>
Total customer accounts	<u>4,403</u>	<u>3,868</u>

As at December 31, 2011, accrued interest expense included in customer accounts amounted to AZN 69 thousand (2010: AZN 93 thousand).

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) (In thousands of Azerbaijani Manats)

Term deposits placed by individual depositors bear average interest of 8.9% p.a. (2010: 11.4% p.a.).

Economic sector concentrations within customer accounts are as follows:

	December 31, 2011	December 31, 2010
Insurance	2,363	2,013
Individuals	1,702	1,470
Public organizations	264	249
Trading	74	82
Construction	-	54
Total customer accounts	4,403	3,868

As at December 31, 2011, customer accounts in the amount of AZN 2,646 thousand (60%) were due to six customers (2010: AZN 2,400 thousand (62%) due to five customer).

22. SUBORDINATED DEBT

As at December 31, 2011 the Bank had two subordinated loan balances with the Parent, for principal amount of AZN 3,343 thousand in denominated amount of USD 4,250 thousand (2010: AZN 3,391 thousand in denominated amount of USD 4,250 thousand). These borrowings are maturing on December 10, 2014 and August 31, 2015. They bear annual interest rate of 9.84% (2010: 9.84%).

As at December 31, 2011, accrued interest expense included in subordinated debt amounted to AZN 23 thousand (2010: AZN 23 thousand).

Interest payables on loans are on a quarterly basis and the principal payables are on the maturity dates. In the event of bankruptcy or liquidation of the Bank's repayment of this loan is subordinate to the repayment of the Bank's liabilities to all other creditors.

The management of the Bank is currently leading negotiations with the Parent for prolongation of these loans for an additional period of one year.

23. OTHER LIABILITIES

Other liabilities comprise:

	December 31, 2011	December 31, 2010
Other financial liabilities:		
Payables for professional services	11	11
Settlements with suppliers	1	4
Payables to employees	276	-
	288	15

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	December 31, 2011	December 31, 2010
Other non-financial liabilities:		
Payables to the state budget and local funds	61	-
Other	8	1
Taxes other than income tax	1	4
	<u> </u>	<u> </u>
Total other liabilities	<u> 358</u>	<u> 20</u>

24. SHARE CAPITAL

As at December 31, 2011 and December 31, 2010 the Bank’s shareholders’ authorized, issued and fully paid capital amounted to AZN 23,815 thousand and comprised 119,075 thousand ordinary shares with a par value of AZN 0.2. All shares are ranked equally and carry one vote.

The share capital of the Bank in AZN was contributed by the shareholders and they are entitled to dividends and any capital distribution. In accordance with the laws of the Republic of Azerbaijan, the shareholders of the Bank should have the following rights: participate in the management of the Bank, 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.

25. COMMITMENTS AND CONTINGENCIES

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

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

The Bank uses the same credit control and management policies in undertaking contingent commitments as it does for the financial instruments reported in the statement of financial position.

	December 31, 2011	December 31, 2010
Guarantees and credit-related commitments		
Guarantees	1,042	20
Commitments on loans and unused credit lines	196	52
Letters of credit	-	396
	<u> </u>	<u> </u>
Commitments and contingencies	<u> 1,238</u>	<u> 468</u>

As at December 31, 2011 guarantees in the amount of AZN 1,042 thousand were disbursed to “DNS Computers” LLC. These guarantees are maturing at August 9, 2012 and January 25, 2013. Management considers that outflow of resources is not probable for these guarantees.

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Operating lease commitments

Where the Bank is the lessee, the future minimum lease payments under non cancellable operating leases of building are as follows:

	December 31, 2011	December 31, 2010
Less than 1 year	<u>745</u>	<u>801</u>
Total operating lease commitments	<u>745</u>	<u>801</u>

Capital commitments

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

Taxation

Azerbaijani commercial legislation and tax legislation, in particular, may give rise to varying interpretations and amendments. In addition, as management’s interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result the Bank may be assessed additional taxes, penalties and interest. Tax years remain open to review by the tax authorities for three years. Management believes that the Bank has already made all tax payments that are due, and therefore no provisions have been made in these financial statements for any potential liabilities.

Pensions and retirement plans

Employees receive pension benefits from the Republic of Azerbaijan in accordance with the laws and regulations of the country. As at December 31, 2011 and 2010, the Bank was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

26. TRANSACTIONS WITH RELATED PARTIES

Related parties or transactions with related parties, as defined by IAS 24 “Related Party Disclosures”, represent:

- (a) Parties that directly, or indirectly through one or more intermediaries: control, or are controlled by, or are under common control with, the Bank (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Bank that gives them significant influence over the Bank; and that have joint control over the Bank;
- (b) Associates – enterprises on which the Bank has significant influence and which is neither a subsidiary nor a joint venture of the investor;
- (c) Members of key management personnel of the Bank or its parent;
- (d) Close members of the family of any individuals referred to in (a) or (c);
- (e) Parties that are entities controlled, jointly controlled or significantly influenced by, or for which;
- (f) Significant voting power in such entity resides with, directly or indirectly, any individual referred to in (c) or (d); or
- (g) Post-employment benefit plans for the benefit of employees of the Bank, or of any entity that is a related party of the Bank.

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In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Bank had the following balances outstanding as at December 31, 2011 and 2010 with related parties:

	December 31, 2011		December 31, 2010	
	Related party balances	Total category as per financial statements caption	Related party balances	Total category as per financial statements caption
Loans to customers, net		45,098		13,839
- key management personnel of the Bank or its parent and their close family members	24		35	
Due from banks		485		5,418
- the parent and the parent’s subsidiaries	20		-	
Due to banks		26,902		1,211
- the parent and the parent’s subsidiaries	26,902		1,211	
Customer accounts		4,403		3,868
- the parent and the parent’s subsidiaries	-		1,024	
- key management personnel of the Bank or its parent and their close family members	51		55	
Subordinated debt		3,366		3,414
- the parent and the parent’s subsidiaries	3,366		3,414	
Commitments and contingencies		1,238		468
- key management personnel of the Bank or its parent and their close family members	1		25	

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

	December 31, 2011		December 31, 2010	
	Related party balances	Total category as per financial statements caption	Related party balances	Total category as per financial statements caption
Interest income		4,721		2,928
- key management personnel of the Bank or its parent and their close family members	8		13	
Interest expense		1,171		1,061
- the parent and the parent’s subsidiaries	-		528	
- key management personnel of the Bank or its parent and their close family members	82		56	

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) (In thousands of Azerbaijani Manats)

	December 31, 2011		December 31, 2010	
	Related party balances	Total category as per financial statements caption	Related party balances	Total category as per financial statements caption
Fee and commission expense		60		56
- the parent and the parent’s subsidiaries	1		1	
Operating expenses		5,563		4,551
- key management personnel of the Bank or its parent and their close family members	121		45	
Key management personnel compensation		3,022		2,380
- short-term employee benefits (salaries and bonuses, payroll taxes and social security costs, other employee’s benefits)	480		984	

27. OPERATING SEGMENTS

The Bank’s primary format for operating segment information is business segments and the secondary format is a geographical segment.

Business segments

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

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

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

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) (In thousands of Azerbaijani Manats)

Segment information about these businesses is presented below:

	Retail Banking	Corporate banking	Unallocated	As at and for the year ended December 31, 2011
Interest income	1,503	3,218	-	4,721
Interest expense	(165)	(1,006)	-	(1,171)
Provision for impairment losses on interest bearing assets	(469)	(864)	-	(1,333)
Net gain on foreign exchange operations	-	-	41	41
Fee and commission income	84	139	-	223
Fee and commission expense	(37)	(23)	-	(60)
Other income	-	-	56	56
Operating income	916	1,464	97	2,477
Operating expenses	(342)	(4,184)	(1,037)	(5,563)
Profit/(loss) before income tax	574	(2,720)	(940)	(3,086)
Segment assets	<u>16,940</u>	<u>30,905</u>	<u>2,312</u>	<u>50,157</u>
Segment liabilities	<u>8,213</u>	<u>25,199</u>	<u>1,617</u>	<u>35,029</u>
Other segment items:				
Depreciation and amortization charge on property, equipment and intangible assets	-	-	730	730
Loans to customers, net	10,701	34,397	-	45,098
Due from banks	-	485	-	485
Property and equipment	-	-	1,345	1,345
Intangible assets	-	-	833	833
Customer accounts	1,702	2,701	-	4,403
Due to banks	-	26,902	-	26,902
Subordinated debt	-	3,366	-	3,366

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) (In thousands of Azerbaijani Manats)

	Retail Banking	Corporate banking	Unallocated	As at and for the year ended December 31, 2010
Interest income	181	2,612	135	2,928
Interest expense	(363)	(692)	(6)	(1,061)
Provision for impairment losses on interest bearing assets	-	(1,493)	-	(1,493)
Net gain on foreign exchange operations	-	-	25	25
Fee and commission income	49	81	-	130
Fee and commission expense	(35)	(21)	-	(56)
Other income	-	-	7	7
Operating (loss)/income	(168)	487	161	480
Operating expenses	(280)	(3,423)	(848)	(4,551)
Loss before income tax	(448)	(2,936)	(687)	(4,071)
Segment assets	<u>9,026</u>	<u>16,469</u>	<u>1,232</u>	<u>26,727</u>
Segment liabilities	<u>1,996</u>	<u>6,124</u>	<u>393</u>	<u>8,513</u>
Other segment items:				
Depreciation and amortization charge on property, equipment and intangible assets	-	-	638	638
Loans to customers, net	7,374	6,465	-	13,839
Due from banks	-	5,418	-	5,418
Property and equipment	-	-	1,585	1,585
Intangible assets	-	-	386	386
Customer accounts	1,470	2,398	-	3,868
Due to banks	-	1,211	-	1,211
Subordinated debt	-	3,414	-	3,414

The Bank's assets are mainly located in the Republic of Azerbaijan and major parts of its revenue and net loss arrives from operations in the Republic of Azerbaijan.

28. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

	December 31, 2011		December 31, 2010	
	Carrying value	Fair value	Carrying value	Fair value
Cash and cash equivalents	1,081	1,081	3,663	3,663
Mandatory reserves with the CBRA	773	773	10	10
Due from banks	485	485	5,418	5,418
Loans to customers	45,098	45,098	13,839	13,839
Available-for-sale investments	-	-	621	621
Held-to-maturity investments	-	-	947	947
Other financial assets	43	43	9	9
Due to banks	26,902	26,902	1,211	1,211
Customer accounts	4,403	4,403	3,868	3,868
Subordinated debt	3,366	3,366	3,414	3,414
Other financial liabilities	288	288	15	15

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

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

As at December 31, 2011 there were no balances of financial instruments recorded at fair value.

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

December 31, 2010	Level 1	Level 2	Level 3	Total
Financial assets				
Available-for-sale investments				
Coupon bonds of the Azerbaijan				
Mortgage Fund under the CBRA	-	621	-	621

The methods and assumptions applied in determining fair values

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

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

29. REGULATORY MATTERS

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total (12%) and tier 1 capital (6%) to risk weighted assets.

The ratio was calculated according to the principles employed by the CBRA by applying the following risk estimates to the assets and off-balance sheet commitments net of allowances for impairment losses:

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

As at December 31, 2011, the Bank's total capital amount for Capital Adequacy purposes was AZN 15,607 thousand and tier 1 capital amount was AZN 13,409 thousand with ratios of 29.36% and 25.23%, respectively.

As at December 31, 2010, the Bank's total capital amount for Capital Adequacy purposes was AZN 19,726 thousand and tier 1 capital amount was AZN 17,194 thousand with ratios of 82.9% and 72.3%, respectively.

As at December 31, 2011 due to providing a loan facility to “Azerbaijan Methanol Company” LLC in the amount of AZN 26,741, thousand the Bank has breached statutory requirement on capital adequacy ratio, which resulted in a ratio of maximum amount of single facility to total equity of 25%, imposed by CBRA. CBRA rules imply that the amount of single loan facility to total equity must not exceed 25% if the loan facility has been covered by collaterals and 10%, if it has not been covered by collateral. Although the Bank breached the imposed rule, there is written confirmation from CBRA which states that, CBRA is aware of the fact and this incompliance will not affect the business of the Bank.

30. MANAGEMENT OF CAPITAL

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

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

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

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31. RISK MANAGEMENT POLICIES

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

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

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

Credit risk

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

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

Maximum Exposure

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

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

				December 31, 2011
	Maximum exposure	Net exposure after offset	Collateral pledged	Net exposure after offset and collateral
Due from banks	485	485	-	485
Loans to customers	45,098	45,098	40,743	4,355
Other financial assets	43	43	-	43
				December 31, 2010
	Maximum exposure	Net exposure after offset	Collateral pledged	Net exposure after offset and collateral
Due from banks	5,418	5,418	-	5,418
Loans to customers	13,839	13,839	12,994	845
Available-for-sale investments	621	621	-	621
Held-to-maturity investments	947	947	-	947
Other financial assets	9	9	-	9

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

							December 31, 2011
	A	A+	B	B-	BBB	Not rated	Total
Cash and cash equivalents	22	19	-	27	908	878	1,854
Due from banks	-	-	10	-	20	454	484
Loans to customers	-	-	-	-	-	45,098	45,098
Other financial assets	-	-	-	-	-	43	43

							December 31, 2010
	A+	B-	BBB-	BBB	<BBB	Not rated	Total
Cash and cash equivalents	14	13	224	1,077	-	2,375	3,703
Due from banks	-	-	-	20	10	5,388	5,418
Loans to customers	-	-	-	-	-	13,839	13,839
Available-for-sale	-	-	-	-	-	621	621
Held-to-maturity	-	-	-	-	-	947	947
Other financial assets	-	-	-	-	-	9	9

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

The following table details carrying value of financial assets that are impaired and the ageing of those that are past due to not impaired:

	Financial assets past due but not impaired						December 31, 2011
	Neither past due nor impaired	0-3 months	3-6 months	6 months to 1 year	Greater than one year	Financial assets that have been impaired	Total
Due from banks	485	-	-	-	-	-	485
Loans to customers	42,406	1,676	45	-	-	971	45,098
Other financial assets	43	-	-	-	-	-	43

	Financial assets past due but not impaired						December 31, 2010
	Neither past due nor impaired	0-3 months	3-6 months	6 months to 1 year	Greater than one year	Financial assets that have been impaired	Total
Due from banks	5,418	-	-	-	-	-	5,418
Loans to customers	12,832	-	-	-	-	1,007	13,839
Available-for-sale investments	621	-	-	-	-	-	621
Held-to-maturity investments	947	-	-	-	-	-	947
Other financial assets	9	-	-	-	-	-	9

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Geographical concentration

The Assets and Liabilities Management Committee (“ALMC”) exercises control over the risk in the legislation and regulatory areas and assesses its influence on the Bank’s activities. This approach allows the Bank to minimize potential losses from investment climate fluctuations in the Republic of Azerbaijan.

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

	The Republic of Azerbaijan	Other non- OECD countries	OECD countries	December 31, 2011 Total
FINANCIAL ASSETS				
Cash and cash equivalents	971	53	57	1,081
Mandatory reserves with the CBRA	773	-	-	773
Due from banks	465	-	20	485
Loans to customers	45,098	-	-	45,098
Other financial assets	43	-	-	43
TOTAL FINANCIAL ASSETS	47,350	53	77	47,480
FINANCIAL LIABILITIES				
Due to banks	-	26,902	-	26,902
Customer accounts	4,403	-	-	4,403
Subordinated debt	-	3,366	-	3,366
Other financial liabilities	288	-	-	288
TOTAL FINANCIAL LIABILITIES	4,691	30,268	-	34,959
NET POSITION	42,659	(30,215)	77	12,521
	The Republic of Azerbaijan	Other non- OECD countries	OECD countries	December 31, 2010 Total
FINANCIAL ASSETS				
Cash and cash equivalents	3,585	24	54	3,663
Mandatory reserves with the CBRA	10	-	-	10
Due from banks	5,418	-	-	5,418
Loans to customers	13,839	-	-	13,839
Available-for-sale investments	621	-	-	621
Held-to-maturity investments	947	-	-	947
Other financial assets	9	-	-	9
TOTAL FINANCIAL ASSETS	24,429	24	54	24,507
FINANCIAL LIABILITIES				
Due to banks	-	1,211	-	1,211
Customer accounts	3,868	-	-	3,868
Subordinated debt	-	3,414	-	3,414
Other financial liabilities	15	-	-	15
TOTAL FINANCIAL LIABILITIES	3,883	4,625	-	8,508
NET POSITION	20,546	(4,601)	54	15,999

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) *(In thousands of Azerbaijani Manats)*

Liquidity risk

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

ALMC controls these types of risks by means of maturity analysis, determining the Bank’s strategy for the next financial period. Current liquidity is managed by the ALMC, which deals in the money markets for current liquidity support and cash flow optimization.

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

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

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

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	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Overdue	December 31, 2011 Total
FINANCIAL ASSETS							
Due from banks	485	-	-	-	-	-	485
Loans to customers	50	564	24,402	20,082	-	-	45,098
Total interest bearing financial assets	535	564	24,402	20,082	-	-	45,583
Cash and cash equivalents	1,081	-	-	-	-	-	1,081
Mandatory reserves with the CBRA	773	-	-	-	-	-	773
Other financial assets	43	-	-	-	-	-	43
TOTAL FINANCIAL ASSETS	2,432	564	24,402	20,082	-	-	47,480
FINANCIAL LIABILITIES							
Due to banks	2,294	24,608	-	-	-	-	26,902
Customer accounts	-	-	84	3,209	-	-	3,293
Subordinated debt	-	3,366	-	-	-	-	3,366
Total interest bearing financial liabilities	2,294	27,974	84	3,209	-	-	33,561
Customer accounts	1,110	-	-	-	-	-	1,110
Other financial liabilities	288	-	-	-	-	-	288
TOTAL FINANCIAL LIABILITIES	3,692	27,974	84	3,209	-	-	34,959
Liquidity gap	(1,260)	(27,410)	24,318	16,873	-	-	12,521
Interest sensitivity gap	(1,759)	(27,410)	24,318	16,873	-	-	-
Cumulative interest sensitivity gap	(1,759)	(29,169)	(4,851)	12,022	-	-	-
Cumulative interest sensitivity gap as a percentage of total assets	(3%)	(58%)	(10%)	24%	-	-	-

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) (In thousands of Azerbaijani Manats)

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Overdue	December 31, 2010 Total
FINANCIAL ASSETS							
Due from banks	-	-	5,418	-	-	-	5,418
Loans to customers	384	514	4,341	8,600	-	-	13,839
Available-for-sale investments	-	-	-	-	621	-	621
Held-to-maturity investments	-	947	-	-	-	-	947
Total interest bearing financial assets	384	1,461	9,759	8,600	621	-	20,825
Cash and cash equivalents	3,663	-	-	-	-	-	3,663
Mandatory reserves with the CBRA	10	-	-	-	-	-	10
Other financial assets	9	-	-	-	-	-	9
TOTAL FINANCIAL ASSETS	4,066	1,461	9,759	8,600	621	-	24,507
FINANCIAL LIABILITIES							
Due to banks	-	-	1,211	-	-	-	1,211
Customer accounts	123	1,485	832	572	-	-	3,012
Subordinated debt	-	-	-	3,414	-	-	3,414
Total interest bearing financial liabilities	123	1,485	2,043	3,986	-	-	7,637
Customer accounts	856	-	-	-	-	-	856
Other financial liabilities	15	-	-	-	-	-	15
TOTAL FINANCIAL LIABILITIES	994	1,485	2,043	3,986	-	-	8,508
Liquidity gap	3,072	(24)	7,716	4,614	621	-	15,989
Interest sensitivity gap	261	(24)	7,716	4,614	621	-	-
Cumulative interest sensitivity	261	237	7,953	12,567	13,188	-	-
Cumulative interest sensitivity gap as a percentage of total	1%	1%	30%	47%	49%	-	-

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

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

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

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) (In thousands of Azerbaijani Manats)

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	December 31, 2011 Total
FINANCIAL LIABILITIES								
Due to banks	3.48%	2,595	24,583	-	-	-	-	27,178
Customer accounts	8.9%	-	-	86	3,301	-	-	3,387
Subordinated debt	9.84%	27	3,400	-	-	-	-	3,427
Total interest bearing financial liabilities		<u>2,622</u>	<u>27,983</u>	<u>86</u>	<u>3,301</u>	<u>-</u>	<u>-</u>	<u>33,992</u>
Customer accounts		1,110	-	-	-	-	-	1,110
Other financial liabilities		288	-	-	-	-	-	288
TOTAL FINANCIAL LIABILITIES		<u>4,020</u>	<u>27,983</u>	<u>86</u>	<u>3,301</u>	<u>-</u>	<u>-</u>	<u>35,390</u>

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	December 31, 2010 Total
FINANCIAL LIABILITIES								
Due to banks	5.12%	5	15	1,242	-	-	-	1,262
Customer accounts	10.9%	133	1,496	837	627	-	-	3,093
Subordinated debt	9.84%	27	82	247	5,064	-	-	5,420
Total interest bearing financial liabilities		<u>165</u>	<u>1,593</u>	<u>2,326</u>	<u>5,691</u>	<u>-</u>	<u>-</u>	<u>9,775</u>
Customer accounts		856	-	-	-	-	-	856
Other financial liabilities		15	-	-	-	-	-	15
TOTAL FINANCIAL LIABILITIES		<u>1,036</u>	<u>1,593</u>	<u>2,326</u>	<u>5,691</u>	<u>-</u>	<u>-</u>	<u>10,646</u>

Market Risk

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

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

The majority of the Bank's loan contracts and other financial assets and liabilities bear fixed interest rates. The Bank monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) (In thousands of Azerbaijani Manats)

Interest rate risk

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

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

Impact on profit before tax:

	December 31, 2011		December 31, 2010	
	Interest rate +1%	Interest rate -1%	Interest rate +1%	Interest rate -1%
FINANCIAL ASSETS				
Due from banks	5	(5)	54	(54)
Loans to customers	451	(451)	139	(139)
FINANCIAL LIABILITIES				
Due to banks	(269)	269	(12)	12
Customer accounts	(33)	33	(30)	30
Subordinated debt	(34)	34	(34)	34
Net impact on profit before tax	120	(120)	117	(117)

Currency risk

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

The Management Board sets limits on the level of exposure by currencies, which give the Bank an opportunity to minimize losses from significant currency rates fluctuations toward its functional currency. The ALMC performs daily monitoring of the Bank’s open currency position with the aim to match the requirement of the CBRA. These limits also comply with the minimum requirements of the CBRA.

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

	AZN	USD	EUR	Other currency	December 31, 2011 Total
FINANCIAL ASSETS					
Cash and cash equivalents	412	1,357	23	62	1,854
Due from banks	-	485	-	-	485
Loans to customers	15,355	29,743	-	-	45,098
TOTAL FINANCIAL ASSETS	15,767	31,585	23	62	47,437

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) (In thousands of Azerbaijani Manats)

	AZN	USD	EUR	Other	December 31, 2011 Total
FINANCIAL LIABILITIES					
Due to banks	79	26,823	-	-	26,902
Customer accounts	2,663	1,686	20	34	4,403
Subordinated debt	-	3,366	-	-	3,366
TOTAL FINANCIAL LIABILITIES	2,742	31,875	20	34	34,671
OPEN CURRENCY POSITION	13,025	(290)	3	28	12,766

	AZN	USD	EUR	Other currency	December 31, 2010 Total
FINANCIAL ASSETS					
Cash and cash equivalents	2,685	899	55	24	3,663
Mandatory reserves with the CBRA	10	-	-	-	10
Due from banks	2,470	2,948	-	-	5,418
Loans to customers	11,057	2,782	-	-	13,839
Available-for-sale investments	621	-	-	-	621
Held-to-maturity investments	947	-	-	-	947
Other financial assets	9	-	-	-	9
TOTAL FINANCIAL ASSETS	17,799	6,629	55	24	24,507
FINANCIAL LIABILITIES					
Due to banks	-	1,211	-	-	1,211
Customer accounts	1,859	1,949	53	7	3,868
Subordinated debt	-	3,414	-	-	3,414
Other financial liabilities	15	-	-	-	15
TOTAL FINANCIAL LIABILITIES	1,874	6,574	53	7	8,508
OPEN CURRENCY POSITION	15,925	55	2	17	-

Currency risk sensitivity

The following tables provide in detail the Bank’s sensitivity to a 10% increase and decrease in the USD and EUR against the AZN. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management’s assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Bank where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

	As at December 31, 2011		As at December 31, 2010	
	AZN/USD +10%	AZN/USD -10%	AZN/USD +10%	AZN/USD -10%
Net impact on earnings before tax	(29)	29	6	(6)

“BANK VTB (AZERBAIJAN)” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011 (Continued) *(In thousands of Azerbaijani Manats)*

Limitations of sensitivity analysis

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

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

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

32. EVENTS AFTER THE END OF THE REPORTING PERIOD

During March, 2012 and February 2012 the Bank attracted long-term funds from RosEvroBank OJSC in the total amount of AZN 13,371 thousand, with market interest rates of 5.3% and 7% and a maturity of 1 year and 2 years accordingly.

On February 2012 the Bank repaid funds borrowed from the Parent in the total amount of AZN 3,146 thousand.