

**OPEN JOINT STOCKCOMPANY  
XALQ BANK**

**INDEPENDENT AUDITORS' REPORT  
AND  
CONSOLIDATED FINANCIAL STATEMENTS**

**31 DECEMBER 2014**

# Open Joint Stock Company Xalq Bank

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## Statement of Management's Responsibilities for the Preparation and Approval of the Consolidated Financial Statements for the Year Ended 31 December 2014

The following statement, which should be read in conjunction with the independent auditors' responsibilities stated in the independent auditors' report set out on pages 2-3, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the consolidated financial statements of Open Joint Stock Company Xalq Bank (the "Group").

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of the Group at 31 December 2014, and 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 consolidated 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 consolidated financial statements; and
- Preparing the consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group 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 Group;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Detecting and preventing fraud and other irregularities.

The consolidated financial statements for the year ended 31 December 2014 were authorized for issue on 17 April 2015 by the Management Board.

Approved for issue and signed on behalf of the Management Board on 17 April 2015.

  
Chairman  
Mr. Elkhon Aghayev

  
Chief Accountant  
Mrs. Tamilla Asadova



## **Independent auditors' report**

To the Shareholders and Board of Directors of Open Joint Stock Company Xalq Bank

We have audited the accompanying consolidated financial statements of OJSC Xalq Bank and its subsidiaries, which comprise the consolidated statement of financial position as at 31 December 2014, and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

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

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of 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 consolidated 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 auditor's 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 consolidated financial statements present fairly, in all material respects, the financial position of OJSC Xalq Bank and its subsidiaries as at 31 December 2014, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

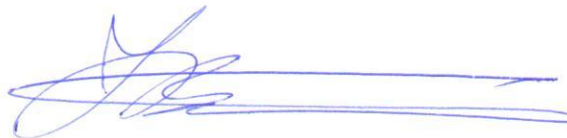
**Emphasis of Matter**

We would like to draw your attention to Note 30 "Subsequent Events" of the financial statements, which describes the decision made by Management Board of Central Bank of Azerbaijan Republic to devalue the Azerbaijan Manat (AZN) approximately by 34 percent. As the result of this decision OJSC Xalq Bank and its subsidiaries incurred total loss of AZN 28 million. Our opinion is not modified in respect of this matter.

17 April 2015  
Baku, Azerbaijan Republic



Samir Asadullayev  
Certified auditor



Juris Baltgailis  
Partner



# Open Joint Stock Company Xalq Bank

## Consolidated Statement of Comprehensive Income for the year ended 31 December 2014 (in Azerbaijan Manats)

	Notes	Year ended 31 December 2014	Year ended 31 December 2013
Interest income	4	86,998,421	77,118,762
Interest expense	4	(35,876,504)	(32,763,626)
<b>NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS</b>		<b>51,121,917</b>	<b>44,355,136</b>
(Provision) / recovery of provision for impairment losses on interest bearing assets	5	(16,222,350)	(3,656,444)
<b>NET INTEREST INCOME</b>		<b>34,899,567</b>	<b>40,698,692</b>
Net gain on foreign exchange operations	7	936,323	1,879,695
Net gain / (loss) on gold operations	6	(384,558)	(6,098,453)
Fee and commission income	8	4,488,248	4,909,466
Fee and commission expense	8	(711,262)	(658,052)
Gain / (loss) on revaluation of investment property	17	2,207	316,712
Provision for impairment losses on non-interest bearing assets	18	(918,276)	-
Other income		416,827	841,447
<b>NET NON-INTEREST INCOME</b>		<b>3,829,509</b>	<b>1,190,815</b>
<b>OPERATING INCOME</b>		<b>38,729,076</b>	<b>41,889,507</b>
<b>OPERATING EXPENSES</b>	9	<b>(27,446,922)</b>	<b>(24,427,778)</b>
<b>OPERATING PROFIT</b>		<b>11,282,154</b>	<b>17,461,729</b>
Recovery of provision for impairment losses on guarantees and other commitments	5	4,162,382	(3,450,308)
<b>PROFIT BEFORE INCOME TAX</b>		<b>15,444,536</b>	<b>14,011,421</b>
Income tax (expense) / benefit	10	(3,173,231)	(3,157,427)
<b>NET PROFIT FOR THE YEAR</b>		<b>12,271,305</b>	<b>10,853,994</b>
Net profit for the year attributable to:			
Equity holders of the parent		12,271,332	10,842,891
Non-controlling interest		(27)	11,103
		<u>12,271,305</u>	<u>10,853,994</u>
<b>EARNINGS PER SHARE</b>			
<i>Basic and diluted (AZN)</i>	11	<u>3.380</u>	<u>2.987</u>

Approved for issue and signed on behalf of the Management Board on 17 April 2015.

Chairman  
Mr. Elkhan Aghayev

Chief Accountant  
Mrs. Tamilla Asadova



# Open Joint Stock Company Xalq Bank

## Consolidated Statement of Financial Position as at 31 December 2014 (in Azerbaijan Manats)

	Notes	31 December 2014	31 December 2013
<b>ASSETS</b>			
Cash and cash equivalents	12	56,709,157	83,808,518
Gold		6,600,521	6,831,161
Due from banks	13	42,344,888	42,880,958
Loans to customers	14	1,036,251,291	986,012,005
Investments available-for-sale	15	22,557,181	55,213,861
Property and equipment	16	73,356,516	75,522,590
Investment property	17	6,693,719	6,691,512
Intangible assets	16	1,874,887	1,927,592
Deferred income tax asset	10	1,573,580	1,003,798
Other assets	18	7,456,143	6,060,292
<b>TOTAL ASSETS</b>		<b>1,255,417,883</b>	<b>1,265,952,287</b>
<b>LIABILITIES</b>			
Due to banks and government agencies	19	202,130,242	195,331,124
Customer accounts	20	838,428,513	864,199,638
Provision for impairment losses on other operations	5	211,331	4,373,713
Current income tax liability		974,074	1,344,482
Other liabilities	21	5,017,873	4,267,053
<b>TOTAL LIABILITIES</b>		<b>1,046,762,033</b>	<b>1,069,516,010</b>
<b>EQUITY</b>			
Share capital	22	197,125,290	183,693,180
Retained earnings		11,400,485	12,561,263
Non-controlling interest		130,075	181,834
<b>TOTAL EQUITY</b>		<b>208,655,850</b>	<b>196,436,277</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>1,255,417,883</b>	<b>1,265,952,287</b>

Approved for issue and signed on behalf of the Management Board on 17 April 2015.



Chairman  
Mr. Elkhan Aghayev



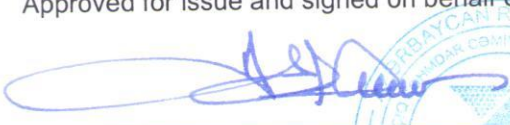

Chief Accountant  
Mrs. Tamilla Asadova

# Open Joint Stock Company Xalq Bank

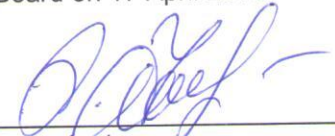
## Consolidated Statement of Changes in Equity for the year ended 31 December 2014 (in Azerbaijan Manats)

	Share capital	Retained earnings / (Accumulated deficit)	Non-controlling interest	Total equity
31 December 2012	169,099,374	16,312,178	170,731	185,582,283
Increase in par value of shares	14,593,806	(14,593,806)	-	-
Total income for the year	-	10,842,891	11,103	10,853,994
31 December 2013	183,693,180	12,561,263	181,834	196,436,277
Increase in par value of shares	13,432,110	(13,432,110)	-	-
Total income for the year	-	12,271,332	(27)	12,271,305
Change in ownership interest in subsidiary	-	-	(51,732)	(51,732)
31 December 2014	<u>197,125,290</u>	<u>11,400,485</u>	<u>130,075</u>	<u>208,655,850</u>

Approved for issue and signed on behalf of the Management Board on 17 April 2015.

  
Chairman  
Mr. Elkhan Aghayev



  
Chief Accountant  
Mrs. Tamilla Asadova



# Open Joint Stock Company Xalq Bank

## Consolidated Statement of Cash Flows for the year ended 31 December 2014 (in Azerbaijan Manats)

	Notes	Year ended 31 December 2014	Year ended 31 December 2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Profit before income tax		15,444,536	14,011,421
Adjustments for:			
Provision / (recovery of provision) for impairment losses on interest bearing assets	5	16,222,350	3,656,444
Recovery of provision for guarantees and other commitments		(4,162,382)	3,450,308
Net unrealized (gain) / loss arising from changes in foreign currency exchange rates		115,155	(144,091)
Depreciation and amortization	16	5,417,461	4,978,682
Gain on revaluation of investment property	17	(2,207)	(316,712)
Gain on disposal of property and equipment		44,379	(203,853)
Loss / (gain) on disposal of intangible assets		-	2,341
Change in interest accruals, net		<u>(4,045,519)</u>	<u>(6,002,662)</u>
Cash flows from operating activities before changes in operating assets and liabilities		29,033,773	19,431,878
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposit with the Central Bank of Azerbaijan Republic		10,562,903	(4,135,460)
Gold		230,640	2,544,745
Due from banks		5,673,488	(7,594,038)
Loans to customers		(61,346,670)	(332,480,236)
Other assets		(1,403,349)	(776,545)
Increase/(decrease) in operating liabilities:			
Due to banks and government agencies		6,865,682	83,030,899
Customer accounts		(26,062,189)	326,231,330
Other liabilities		<u>750,812</u>	<u>1,223,261</u>
Cash inflow / (outflow) from operating activities before taxation		<u>(35,694,910)</u>	<u>87,475,834</u>
Income tax paid		<u>(4,113,420)</u>	<u>(2,376,937)</u>
Net cash inflow / (outflow) from operating activities		<u>(39,808,330)</u>	<u>85,098,897</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of property, equipment and intangible assets	16	(3,443,372)	(8,021,502)
Proceeds on disposal of property and equipment		200,310	268,618
Purchase of investments available-for-sale		31,788,781	(36,354,093)
Acquisition of subsidiary, net of cash acquired		<u>(51,732)</u>	<u>-</u>
Net cash outflow from investing activities		<u>28,493,987</u>	<u>(44,106,977)</u>

# Open Joint Stock Company Xalq Bank

## Consolidated Statement of Cash Flows for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

	Notes	Year ended 31 December 2014	Year ended 31 December 2013
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Issue of ordinary share capital		-	-
Net cash inflow from financing activities		-	-
Effect of foreign exchange rate changes on cash and cash equivalents		(115,155)	144,091
NET INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS		(11,429,498)	41,136,011
CASH AND CASH EQUIVALENTS, beginning of year		96,830,011	55,694,000
CASH AND CASH EQUIVALENTS, end of year	12	85,400,513	96,830,011

Interest paid and received by the Group in cash during the year ended 31 December 2014 amounted to AZN 35,652,003 and AZN 82,728,399, respectively.

Interest paid and received by the Group in cash during the year ended 31 December 2013 amounted to AZN 32,357,872 and AZN 70,710,345, respectively.

Approved for issue and signed on behalf of the Management Board on 17 April 2015.

	
Chairman Mr. Elkhan Aghayev	Chief Accountant Mrs. Tamilla Asadova



# Open Joint Stock Company Xalq Bank

## Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (in Azerbaijan Manats)

### 1. Background

Xalq Bank is a joint stock company which was established on 24 December 2004 in accordance with establishment agreement and was registered by the Central Bank of Azerbaijan Republic on 27 December 2004. The address of its registered office is 1145 Babek Avenue, Baku, AZ 1025, Azerbaijan. The Bank is regulated by the Central Bank of Azerbaijan Republic (the "CBAR") and conducts its business under the general banking license number 246. The Bank had 25 branches in Azerbaijan as at 31 December 2014. The Bank's primary business consists of commercial activities, trading with foreign currencies, originating loans and guarantees.

The number of employees of the Bank at 31 December 2014 and 2013 was 543 and 518, respectively.

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

Name	Country of operation	The Bank ownership interest/ voting rights		Type of operation
		2014	2013	
<i>Xalq Kapital LLC</i>	<i>The Republic of Azerbaijan</i>	100 %	100%	<i>Securities market transactions</i>
<i>Baki Ayaqqabi -2 OJSC</i>	<i>The Republic of Azerbaijan</i>	98.04%	97.27%	<i>Dormant</i>

"Xalq Kapital" LLC is a limited liability company registered in the Republic of Azerbaijan on 17 August 2007. The company's principal activity is operations with securities, broker and dealer operations.

"Baki Ayaqqabi -2" OJSC is a Joint Stock Company registered in the Republic of Azerbaijan in December 1980. The Company's principal activity had been the manufacture of footwear. The Company has not been functioning since June 1999. The Group has acquired the controlling interest in the Company's capital with the primary purpose of using it as investment property. The Group's management is still uncertain of the detailed plans regarding the Company.

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

	31 December 2014	31 December 2013
	Ownership interest, %	Ownership interest, %
Ideal Biznes Ko LLC	50.00	50.00
Yevro Standart LLC	33.85	33.85
Avangard-1 LLC	16.15	16.15
<b>Total</b>	<b>100</b>	<b>100</b>

The ultimate controlling party of the Group is L.Aliyeva.

These consolidated financial statements were authorized for issue by the Management Board on 17 April 2015.

# Open Joint Stock Company Xalq Bank

## Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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### 2. Basis of Presentation

#### Accounting basis

These consolidated financial statements of the Group 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”). These consolidated financial statements are presented in Azerbaijan Manats (“AZN”) unless otherwise indicated. These consolidated financial statements have been prepared under the historical cost convention, except for the measurement at fair value of certain financial instruments and measurement of investment property at revalued amounts according to International Accounting Standard (“IAS”) No. 40 “Investment Property”.

The Group maintains its accounting records in accordance with Azerbaijan law. These consolidated financial statements have been prepared based on the Azerbaijani statutory accounting records and have been adjusted to conform with 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.

#### Key assumptions

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts. Such estimates and assumptions are based on the information available to the Group’s management as of the date of the consolidated financial statements. Therefore, actual results could differ from those estimates and assumptions. Estimates that are particularly susceptible to change relate to the provisions for impairment losses and the fair value of financial instruments.

Key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial period include:

	<b>31 December 2014</b>	<b>31 December 2013</b>
Loans to customers	1,036,251,291	986,012,005
Investments available for sale	22,557,181	55,213,861
Property and equipment	73,356,516	75,522,590
Investment Property	6,693,719	6,691,512

Loans to customers are measured at amortized cost less allowance for impairment losses. The estimation of allowances for impairments involves the exercise of significant judgment. The Group estimates allowances for impairment with the objective of maintaining balance sheet provisions at a level believed by management to be sufficient to absorb losses incurred in the Bank’s loan portfolio. The calculation of provisions on impaired loans is based on the likelihood of the asset being written off and the estimated loss on such a write-off. These assessments are made using statistical techniques based on historic experience. These determinations are supplemented by the application of management judgment.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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The Group considers accounting estimates related to provisions for loans key sources 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 losses relating to impaired loans and advances are based on recent performance experience, and (ii) any significant difference between the Group's estimated losses (as reflected in the provisions) and actual losses will require the Group to take provisions which, if significantly different, could have a material impact on its future income statement and its statement of financial position. The Group's assumptions about estimated losses are based on past performance, past customer behaviour, the credit quality of recent underwritten business and general economic conditions, which are not necessarily an indication of future losses.

Investments available-for-sale are measured at fair value less impairment losses. The estimation of impairment losses involves the exercise of significant management judgment. The accounting policy for the impairment of financial instruments is discussed in Note 3 below.

#### Functional currency

Items included in the financial statements of the Group are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that entity (the "functional currency"). The reporting currency of the financial statements is the Azerbaijan Manats ("AZN").

### 3. Summary of Significant Accounting Policies

#### Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and entities controlled by the Bank (its subsidiaries) made up to 31 December each year. Control is achieved where the Bank has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognized as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to the consolidated income statement in the period of acquisition. The minority interest is stated at the minority's proportion of the fair values of the assets and liabilities recognized. Subsequently, any losses applicable to the minority interest in excess of the minority interest are allocated against the interests of the parent. The equity attributable to equity holders of the parent and net income attributable to minority shareholders' interests are shown separately in the consolidated statement of financial position and income statement, respectively.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

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

The difference, if any, between the carrying amount of minority interest and the amount received on its purchase is recognized in equity attributable to the equity holders of the parent.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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#### Investments in associates

An associate is an entity over which the Group is in a position to exercise significant influence, but not control or joint control, through participation in the financial and operating policy decisions of the investee.

The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting.

Investments in associates are carried in the consolidated statement of financial position at cost as adjusted for goodwill and for post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of the associates in excess of the Group's interest in those associates are not recognized.

Any excess of the cost of acquisition over the Group's share of the fair values of the identifiable assets, liabilities and contingent liabilities of the associate at the date of acquisition is recognized as goodwill. The goodwill is included in the carrying amount of the investment and is assessed for impairment as part of the investment. Any deficiency of the cost of acquisition below the Group's share of the fair values of the identifiable assets, liabilities and contingent liabilities of the associate at the date of acquisition (i.e. discount on acquisition) is credited in the consolidated income statement in the period of acquisition.

Where a Group company transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate.

#### Goodwill

Goodwill arising on the acquisition of a subsidiary or jointly controlled entity represents the excess of the cost of acquisition over the Group's interest in the fair value of assets, liabilities and contingent liabilities of a subsidiary as at the date of acquisition. Goodwill is initially recognized as an asset at cost and is subsequently measure at cost less any accumulated impairment losses.

The Group tests goodwill for impairment at least annually. An impairment loss recognized for goodwill is not reversed in a subsequent period.

If the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the Group:

- (a) Reassesses the identification and measurement of the Group's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination; and
- (b) Recognizes immediately in profit or loss any excess remaining after that reassessment.

On disposal of an investment, the amount of goodwill attributable is included in the determination of financial result from disposal.

#### Recognition and measurement of financial instruments

The Group recognizes financial assets and liabilities on its consolidated statement of financial position when it becomes a party to the contractual obligation of the instrument. Regular way purchase and sale of the financial assets and liabilities are recognized using settlement date accounting. Regular way purchases of financial instruments that will be subsequently measured at fair value between trade date and settlement date are accounted for in the same way as for acquired instruments.

Financial assets and liabilities are initially recognized at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss transaction costs that are directly attributable to acquisition or issue of the financial asset or financial liability. The accounting policies for subsequent re-measurement of these items are disclosed in the respective accounting policies set out below.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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#### Cash and cash equivalents

Cash and cash equivalents include cash on hand, unrestricted balances on correspondent and time deposit accounts with the Central Bank of Azerbaijan Republic with original maturity within 90 days, advances to banks in countries included in the Organization for Economic Cooperation and Development ("OECD"). For the purposes of determining cash flows, the minimum reserve deposit required by the Central Bank of Azerbaijan Republic is not included as a cash equivalent due to restrictions on its availability (Note 12).

#### Gold

Assets and liabilities denominated in gold are translated at the current rate computed based on the Central Bank rate effective at the date. Changes in the bid prices are recorded in net gain on operations with gold.

#### Fiduciary activities

The Group provides depository services to its customers which include transactions with securities on their depository accounts. Assets accepted and liabilities incurred under the fiduciary activities are not included in the Group's consolidated financial statements. The Group accepts operational risks relating to these activities, whereas the Group's customers bear the credit and market risks associated with such operations.

#### Due from banks

In the normal course of business, the Group maintains advances and deposits for various periods of time with other banks. 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 stated at amortized cost based on expected dates of maturity. 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 to customers granted by the Group with fixed maturities are initially recognized at fair value plus related transaction costs, directly attributable to the acquisition or creation of qualifying financial assets. 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 consolidated income statement 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.

The Group will take possession of any collateral held as security when a customer defaults on repayments of the loan and the loan cannot be renegotiated. The Group will engage a third party to dispose of the collateral on their behalf in the open market.

#### Factoring Assets

Factoring assets are non-derivative assets with determinable payments. These assets are initially recognized at fair value and any costs directly related to creation of qualifying financial assets.

Where the fair value of consideration given does not equal the fair value of the factoring asset the difference between the fair value of consideration given and the fair value of the asset is recognized as a loss on initial recognition of the asset and included in the consolidated income statement according to nature of these losses. Subsequently, factoring assets are carried at amortized cost using the effective interest method and are carried net of any allowance for impairment losses.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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#### Write-off of loans and advances

Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in the consolidated income statement in the period of recovery.

#### Allowance for impairment losses

##### *Assets carried at amortized cost*

The Group accounts for impairment losses of financial assets that are not carried at fair value when there is objective evidence that a financial asset or group of financial assets is impaired. The 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 adjusting an allowance account.

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

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

If an available-for-sale asset is impaired, a consolidated amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in the consolidated income statement, is transferred from equity to the consolidated income statement. Reversals of impairment losses in respect of equity instruments classified as available-for-sale are not recognized in the consolidated income statement. Reversals of impairment losses on debt instruments are reversed through the consolidated income statement if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss were recognized in the consolidated income statement.

The determination of impairment losses is based on an analysis of the risk assets and reflects the amount which, in the judgment of management, is adequate to provide for losses incurred. Provisions are made as a result of an individual appraisal of risk assets for financial assets that are individually significant, and an individual or collective assessment for financial assets that are not individually significant.

The change in impairment losses is charged to profit either through allowance account (financial assets that are carried at amortized cost) or direct write-off (financial assets carried at cost). The total of the impairment losses is deducted in arriving at assets as shown in the consolidated statement of financial position. Factors that the Group considers in determining whether it has objective evidence that an impairment loss has been incurred include information about the debtors' or issuers' liquidity, solvency and business and financial risk exposures, levels of and trends in delinquencies for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees. These and other factors may, either individually or taken together, provide sufficient objective evidence that an impairment loss has been incurred in a financial asset or group of financial assets.

It should be understood that estimates of losses involve an exercise of judgment. While it is possible that in particular periods the Group may sustain losses which are substantial relative for impairment losses, it is the judgment of management that the impairment losses are adequate to absorb losses incurred on risk assets, at the reporting date.



## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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#### Provisions

Provisions are recognized when the Group 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.

#### Investments available-for-sale

Investments available-for-sale represent debt and equity investments that are intended to be held for an indefinite period of time. Such securities are initially recorded at fair value. Subsequently the securities are measured at fair value, with such re-measurement recognized directly in equity until sold when gain/loss previously recorded in equity recycles through the consolidated income statement, except for impairment losses, foreign exchange gains or losses and interest income accrued using the effective interest method, which are recognized directly in the consolidated income statement. The Group uses quoted market prices to determine the fair value for the Group's investments available-for-sale. If the market for investments is not active, the Group establishes fair value by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and other applicable methods. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the Group uses that technique. Dividends received are included in dividend income in the consolidated income statement.

Non-marketable debt and equity securities are stated at amortized cost and cost, respectively, less impairment losses, if any, unless fair value can be reliably measured.

When there is objective evidence that such securities have been impaired, the cumulative loss previously recognized in equity is removed from equity and recognized in the consolidated income statement for the period. Reversals of such impairment losses on debt instruments, which are objectively related to events occurring after the impairment, are recognized in the consolidated income statement for the period. Reversals of such impairment losses on equity instruments are not recognized in the consolidated income statement.

#### Investment properties

Investment property comprises land or buildings, which are held in order to earn rentals or for capital appreciation or both, and which are not occupied by the companies in the Group or otherwise held for sale. Property held under operating lease is classified as investment property if, and only if, it meets the definition of an investment property. Investment property is carried at fair value. Fair value is based on active market prices, adjusted, if necessary, for any difference in the nature, location or condition of the property. If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections. Changes in the fair value of investment property are recorded in the income statement.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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#### Premises, equipment and intangible assets

Property, equipment and intangible assets are carried at historical cost (except for buildings, which are stated at revalued amounts) 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 of property, equipment and amortization of intangible assets is charged on their historical cost and is designed to write off assets over their useful lives. It is calculated on a straight line basis at the following annual rates:

Building	3.3%
Furniture and equipment	25%
Computers	25%
Vehicles	25%
Other equipment	20%
Intangible assets	10%

The carrying amounts of property, equipment and intangible assets are reviewed at each reporting date to assess whether they are recorded in excess of their recoverable amounts, and where the carrying values exceed the estimated recoverable amounts, the assets are written down to their recoverable amounts. Impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation charge for property and equipment is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

Land and buildings held for use in supply of services, or for administrative purposes, are stated in the consolidated statement of financial position at their revalued amounts, being the fair value at the date of revaluation, determined from market-based evidence by appraisal undertaken by professional independent valuers, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount of the assets does not differ materially from that which would be determined using fair values at the reporting date.

Market value of property is assessed using three methods:

- The comparable sales method which involves analysis of market sales prices for similar real estate property;
- The income-based method which assumes a direct relationship between revenues generated by the property and its market value;
- The cost method which presumes the value of property to be equal to its recoverable amount less any depreciation charges.

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

Depreciation on revalued buildings is charged to the consolidated income statement. Upon the retirement or sale of buildings, the attributable revaluation surplus is transferred to retained earnings.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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#### Taxation

Income tax expense comprises current and deferred taxation. Income tax expense for the current period is determined on the basis of the taxable profit received in the year. Taxable profit differs from net profit as reported in the income statement 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 Group's current tax expense is calculated using tax rates that have been enacted during the reporting period.

Deferred tax is reported using the balance sheet liability method and represents income tax assets and liabilities on the temporary difference between the carrying value of assets and liabilities and the respective tax accounting data used to arrive at the taxable profit. 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 the respective deferred tax assets can be utilized. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in transactions that affect neither the tax profit nor the accounting profit. Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying value of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that a related tax benefit will be realized sufficient for full or partial recovery of the asset.

Deferred tax assets and liabilities are offset by the Group with the resulting difference reported in the financial statements if:

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

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

#### Due to banks and customer accounts

Due to banks and customer accounts are initially recognized at fair value. Subsequently amounts due are stated at amortized cost and any difference between carrying and redemption value is recognized in the consolidated income statement over the period of the borrowings using the effective interest method.

#### Contingencies

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

#### Financial guarantee contracts issued

Financial guarantee contracts issued by the Group are credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. Such financial guarantee contracts issued are initially recognized at fair value. Subsequently they are measured at the higher of (a) the amount recognized as a provision and (b) the amount initially recognized less, where appropriate, cumulative amortization of initial premium revenue received over the financial guarantee contracts issued.

# Open Joint Stock Company Xalq Bank

## Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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### Share capital

Share capital is recognized at cost.

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 period" ("IAS 10") and disclosed accordingly.

### Retirement and other benefit obligations

In accordance with the requirements of the legislation of the Republic of Azerbaijan, the Group withholds amounts of pension contributions from employee salaries and pays them to the state pension fund. Such expense is charged in the period the related salaries are earned. Upon retirement all retirement benefit payments are made by the state pension fund. The Group does not have any pension arrangements separate from the state pension system of Azerbaijan, which requires current contributions by employer calculated as a percentage of current gross salary payments. In addition, the Group has no post-retirement benefits or other significant compensated benefits requiring accrual.

### Recognition of income and expense

Interest income and expense are recognized on an accrual basis using 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 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.

Interests earned on assets at fair value are classified within interest income.

Loan origination fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the loan. Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in the consolidated income statement 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 consolidated income statement on expiry. Loan servicing fees are recognized as revenue as the services are provided. All other commissions are recognized when services are provided.

### Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Azerbaijan Manats at the appropriate spot rates of exchange ruling at the 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 on foreign exchange operations.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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#### Rates of exchange

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

31 December 2014	31 December 2013
USD 1 = AZN 0.7844	USD 1 = AZN 0.7845
EUR 1 = AZN 0.9522	EUR 1 = AZN 1.0780
GBP 1 = AZN 1.2173	GBP 1 = AZN 1.2927
RUR 1 = AZN 0.0133	RUR 1 = AZN 0.0241

#### Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment) or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segments with a majority of revenue earned from sales to external customers and whose revenue, results are ten per cent or more of all the segments are reported separately. No geographical segments of the Group have been reported separately within these consolidated financial statements as all operations are conducted within Azerbaijan.

#### Offset of financial assets and liabilities

Financial assets and liabilities are offset and reported net on the consolidated statement of financial position when the Group has a legally enforceable right to set off the recognized amounts and the Group 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 Group does not offset the transferred asset and the associated liability.

#### Adoption of new or revised standards and interpretations

*Certain new standards and interpretations became effective for the Group from 1 January 2014:*

**Investment Entities – Amendments to IFRS 10 Consolidated Financial Statements, IFRS 12 Disclosure of Interests in Other Entities and IAS 27 Separate Financial Statements.** These amendments provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. These amendments become effective for annual periods beginning on or after 1 January 2014.

**Amendments to IAS 32 Presentation — Offsetting Financial Assets and Financial liabilities:** These amendments clarify the meaning of “currently has a legally enforceable right to set-off” and also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The amendment becomes effective for annual periods beginning on or after 1 January 2014.

**Novation of Derivatives and Continuation of Hedge Accounting – Amendments to IAS 39 Financial Instrument: Recognition and Measurement.** These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. These amendments are effective for annual periods beginning on or after 1 January 2014.

**IFRIC 21 Levies** (issued in May 2013). IFRIC 21 clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. IFRIC 21 becomes effective for annual periods beginning on or after 1 January 2014.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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**Recoverable amount disclosures for non-financial assets – Amendments to IAS 36 Impairment of Assets** (issued in May 2013). The amendments remove the requirement to disclose the recoverable amount when a CGU contains goodwill or indefinite lived intangible assets but there has been no impairment. These amendments are effective for annual periods beginning on or after 1 January 2014.

The above mentioned new or amended standards and interpretations effective from 1 January 2014 did not have a material impact on the accounting policies, financial position or performance of the Group.

#### New Accounting Pronouncements

*Certain new standards and interpretations have been published that become effective for the accounting periods beginning on or after 1 January 2015 or later periods and which are relevant to the Group but not early adopted by the Group.*

**IFRS 9 Financial Instruments: Classification and Measurement** (amended in July 2014 and effective for annual periods beginning on or after 1 January 2018 with early application permitted). In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. Key features of the new standard are:

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).
- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.
- Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.
- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.
- Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

The adoption of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets, but is not expected to have an impact on classification and measurements of the Group's financial liabilities.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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**IFRS 15 Revenue from Contracts with Customers** (issued on 28 May 2014 and effective for the periods beginning on or after 1 January 2017). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed.

**IFRS 14 Regulatory Deferral Accounts** (issued in January 2014 and effective for annual periods beginning on or after 1 January 2016). IFRS 14 permits first-time adopters to continue to recognize amounts related to rate regulation in accordance with their previous GAAP requirements when they adopt IFRS. However, to enhance comparability with entities that already apply IFRS and do not recognize such amounts, the standard requires that the effect of rate regulation must be presented separately from other items.

**Defined benefit plans: Employee contributions – Amendments to IAS 19 Employee Benefits** (issued in November 2013 and effective for annual periods beginning 1 July 2014). The amendment allows entities to recognize employee contributions as a reduction in the service cost in the period in which the related employee service is rendered, instead of attributing the contributions to the periods of service, if the amount of the employee contributions is independent of the number of years of service.

**Accounting for Acquisitions of Interests - Amendments to IFRS 11 Joint Arrangements** (issued on 6 May 2014 and effective for the periods beginning on or after 1 January 2016). The amendments to IFRS 11 require that a joint operator accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business must apply the relevant IFRS 3 principles for business combinations accounting. The amendments also clarify that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation while joint control is retained. In addition, a scope exclusion has been added to IFRS 11 to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party.

**Clarification of Acceptable Methods of Depreciation and Amortisation - Amendments to IAS 16 and IAS 38** (issued on 12 May 2014 and effective for the periods beginning on or after 1 January 2016 with early adoption permitted). The amendments clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets.

**Agriculture: Bearer plants - Amendments to IAS 16 and IAS 41** (issued on 30 June 2014 and effective for annual periods beginning 1 January 2016). The amendments change the financial reporting for bearer plants, such as grape vines, rubber trees and oil palms, which now should be accounted for in the same way as property, plant and equipment because their operation is similar to that of manufacturing. Consequently, the amendments include them within the scope of IAS 16, instead of IAS 41. The produce growing on bearer plants will remain within the scope of IAS 41.

**Equity Method in Separate Financial Statements - Amendments to IAS 27** (effective for annual periods beginning on or after 1 January 2016, with early adoption permitted). The amendments will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying IFRS and electing to change to the equity method in its separate financial statements will have to apply that change retrospectively. First-time adopters of IFRS electing to use the equity method in its separate financial statements will be required to apply this method from the date of transition to IFRS. The Bank currently considers whether to apply these amendments for preparation of its separate financial statements.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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***Sale or Contribution of Assets between an Investor and its Associate or Joint Venture - Amendments to IFRS 10 and IAS 28*** (applied prospectively to transactions occurring in annual periods beginning on or after 1 January 2016. Earlier application is permitted). The amendments address the acknowledged inconsistency between the requirements in IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is contributed to an associate or a joint venture. The amendments clarify that an investor recognises a full gain or loss on the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture. The gain or loss resulting from the re-measurement at fair value of an investment retained in a former subsidiary is recognised only to the extent of unrelated investors' interests in that former subsidiary.

Described above, the new standards and interpretations are not expected to significantly affect the Group's financial statements.

#### **Areas of significant management judgment and sources of estimation uncertainty**

The preparation of the Group'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 Group's financial condition.

#### **Allowance for impairment of loans and receivables**

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

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

The allowances for impairment of financial assets in the consolidated financial statements have been determined on the basis of existing economic and political conditions. The Group is not in a position to predict what changes in conditions will take place in the Republic of Azerbaijan 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 46,295,570 and AZN 30,586,436 as at 31 December 2014 and 2013.



## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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#### Valuation of Financial Instruments

Financial instruments that are classified as available for sale. 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 consolidated income statement 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 Group 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 consolidated statement of financial position as well as its profit/(loss) 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 Group's reported net income.

The carrying amount of the financial instruments at fair value is as follows as at 31 December 2014 and 2013:

	<b>31 December 2014</b>	<b>31 December 2013</b>
Investments available-for-sale	22,557,181	55,213,861

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### 4. Net Interest Income

Net interest income comprise:

	Year ended 31 December 2014	Year ended 31 December 2013
<b>Interest income comprises</b>		
Interest on loans to customers	85,682,925	75,871,083
Interest on debt securities	547,438	565,277
Interest on guarantees	320,515	482,251
Interest on due from banks	271,918	74,959
Interest on other operations	175,625	125,192
	<u>86,998,421</u>	<u>77,118,762</u>
<b>Interest expense comprises:</b>		
Interest on customer accounts	29,794,888	28,116,279
Interest on due to banks and government agencies	6,081,616	4,647,347
	<u>35,876,504</u>	<u>32,763,626</u>
<b>Net interest income before provision for impairment losses on interest bearing assets</b>	<b><u>51,121,917</u></b>	<b><u>44,355,136</u></b>

#### 5. Allowance For Impairment Losses

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

	Debt securities	Due from banks	Loans to customers	Total
<b>31 December 2012</b>	-	<b>300,000</b>	<b>26,669,992</b>	<b>26,969,992</b>
(Recovery of provision) / provision	<u>-</u>	<u>(260,000)</u>	<u>3,916,444</u>	<u>3,656,444</u>
<b>31 December 2013</b>	-	<b>40,000</b>	<b>30,586,436</b>	<b>30,626,436</b>
Provision	<u>125,492</u>	<u>387,724</u>	<u>15,709,134</u>	<u>16,222,350</u>
<b>31 December 2014</b>	<b><u>125,492</u></b>	<b><u>427,724</u></b>	<b><u>46,295,570</u></b>	<b><u>46,848,786</u></b>

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

The movements in provision for impairment losses on guarantees and other commitments were as follows:

	<b>Guarantees and other commitments</b>
<b>31 December 2012</b>	<b>923,405</b>
Provision	<u>3,450,308</u>
<b>31 December 2013</b>	<b>4,373,713</b>
Recovery of provision	<u>(4,162,382)</u>
<b>31 December 2014</b>	<b><u>211,331</u></b>

#### 6. Net (Loss) / Gain on Gold Operations

Net (loss) / gain on gold operations comprise:

	<b>Year ended 31 December 2014</b>	<b>Year ended 31 December 2013</b>
Net gain on gold operations	840	720
Translation difference on gold	<u>(385,398)</u>	<u>(6,099,173)</u>
<b>Total net (loss) / gain on gold operations</b>	<b><u>(384,558)</u></b>	<b><u>(6,098,453)</u></b>

#### 7. Net Gain on Foreign Exchange Operations

Net gain on foreign exchange operations comprise:

	<b>Year ended 31 December 2014</b>	<b>Year ended 31 December 2013</b>
Dealing differences, net	1,051,478	1,735,604
Translation differences, net	<u>(115,155)</u>	<u>144,091</u>
<b>Total net gain on foreign exchange operations</b>	<b><u>936,323</u></b>	<b><u>1,879,695</u></b>

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### 8. Fee and Commission Income and Expense

Fee and commission income and expense comprise:

	Year ended 31 December 2014	Year ended 31 December 2013
<b>Fee and commission income:</b>		
Cash operations	1,595,954	1,339,364
Factoring	1,041,768	855,851
Settlements	702,571	739,085
Plastic cards operations	527,684	635,650
Foreign exchange operations	487,812	860,038
Letters of credit	48,769	325,309
Guarantee letters	20,400	13,973
Other	63,290	140,196
	<u>4,488,248</u>	<u>4,909,466</u>
<b>Fee and commission expense:</b>		
Plastic cards operations	307,704	352,456
Cash operations	243,815	45,390
Settlements	110,611	189,296
Letters of credit	15,383	26,522
Guarantee letters	3,499	6,183
Other	30,250	38,205
	<u>711,262</u>	<u>658,052</u>

#### 9. Operating Expenses

Operating expenses comprise:

	Year ended 31 December 2014	Year ended 31 December 2013
Staff costs	14,045,837	11,289,523
Depreciation and amortization	5,415,112	4,978,678
Payments to the Deposit Insurance Fund of the Republic of Azerbaijan	1,597,438	2,199,358
Security expenses	1,222,735	1,050,873
Operating leases	1,069,962	954,983
Taxes, other than income tax	695,862	692,621
Advertising and marketing expenses	491,111	507,043
Insurance	476,592	440,110
Communications	429,469	379,335
Repairs and maintenance expenses	345,221	333,333
Transportation and business trip expenses	323,372	269,490
Professional services fees	246,826	213,511
Utilities	228,040	199,953
Entertainment	224,900	346,405
Stationery expenses	201,181	225,407
Loss on disposal of property, equipment and intangible assets	48,581	13,299
Membership fees	27,087	34,591
Other expenses	357,596	299,265
	<u>27,446,922</u>	<u>24,427,778</u>

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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#### 10. Income Taxes

The Group provides for taxes based on the tax accounts maintained and prepared in accordance with the tax regulations of countries where the Group and its subsidiaries operate and which may differ from International Financial Reporting Standards.

The Group is subject to certain permanent tax differences due to non-tax deductibility of certain expenses and a tax free regime for certain income. The statutory income tax rate is 20%.

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 31 December 2014 and 2013 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Temporary differences as at 31 December 2014 and 2013 comprise:

	31 December 2014	31 December 2013
<b>Deductible temporary differences:</b>		
Allowance for losses on loans to customers	10,888,394	7,187,847
Amortization	281,622	265,953
Gold	419,681	252,140
Other liabilities	1,990,275	1,359,620
<b>Total deductible temporary differences</b>	<u>13,579,972</u>	<u>9,065,560</u>
<b>Taxable temporary differences:</b>		
Depreciation	(5,712,072)	(4,046,568)
Provision reversal on off balance items	-	-
<b>Total deductible temporary differences</b>	<u>(5,712,072)</u>	<u>(4,046,568)</u>
Net deferred deductible temporary differences	7,867,900	5,018,992
Net deferred tax asset at the statutory tax rate (20%)	<u>1,573,580</u>	<u>1,003,798</u>
<b>Net deferred tax asset</b>	<u><u>1,573,580</u></u>	<u><u>1,003,798</u></u>

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

Relationships between tax expenses and accounting profit for the years ended 31 December 2014 and 2013 are explained as follows:

	Year ended 31 December 2014	Year ended 31 December 2013
Profit before income tax	<u>15,444,536</u>	<u>14,011,421</u>
Tax at the statutory tax rate of 20%	3,088,907	2,802,284
Tax effect of permanent differences	84,324	355,143
<b>Income tax expense / (benefit)</b>	<u><b>3,173,231</b></u>	<u><b>3,157,427</b></u>
Current income tax expense	3,743,013	3,721,419
Deferred income tax expense / (benefit)	(569,782)	(563,992)
<b>Income tax expense / (benefit)</b>	<u><b>3,173,231</b></u>	<u><b>3,157,427</b></u>
	<b>31 December 2014</b>	<b>31 December 2013</b>
<b>Deferred income tax assets</b>		
<b>Beginning of the period</b>	<u><b>1,003,798</b></u>	<u><b>439,806</b></u>
Change in the income tax assets for the period charged to profit	569,782	563,992
<b>End of the period</b>	<u><b>1,573,580</b></u>	<u><b>1,003,798</b></u>

#### 11. Earnings Per Share

The earnings per share are calculated as follows:

	Year ended 31 December 2014	Year ended 31 December 2013
<b>Profit:</b>		
Net profit for the year	<u>12,271,332</u>	<u>10,842,891</u>
Weighted average number of ordinary shares for basic earnings per share	<u>3,630,300</u>	<u>3,630,300</u>
<b>Earnings per share – basic and diluted (AZN)</b>	<u><b>3.380</b></u>	<u><b>2.987</b></u>

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### 12. Cash and Cash Equivalents

Cash and balances with the Central Bank of Azerbaijan Republic comprise:

	31 December 2014	31 December 2013
Cash on hand	13,695,434	33,206,883
Balances with the Central Bank of Azerbaijan Republic	<u>43,013,723</u>	<u>50,601,635</u>
<b>Total cash and balances with the Central Bank of Azerbaijan Republic</b>	<b><u>56,709,157</u></b>	<b><u>83,808,518</u></b>

The balances with the CBAR as at 31 December 2014 and 2013 include AZN 10,550,724 and AZN 21,113,627, respectively, which represent the minimum reserve deposits required by the CBAR. The Bank is entitled to use all funds on its correspondent account provided that average daily balance for 30 days period will be eventually higher than required mandatory reserve.

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

	31 December 2014	31 December 2013
Cash and balances with the Central Bank of Azerbaijan Republic	56,709,157	83,808,518
Due from banks in OECD countries	<u>39,858,463</u>	<u>35,928,153</u>
	96,567,620	119,736,671
Less minimum reserve deposit with the Central Bank of Azerbaijan Republic	(10,550,724)	(21,113,627)
Less restricted deposit in OECD countries	<u>(616,383)</u>	<u>(1,793,033)</u>
<b>Total cash and cash equivalents</b>	<b><u>85,400,513</u></b>	<b><u>96,830,011</u></b>

#### 13. Due from Banks

Due from banks comprise:

	31 December 2014	31 December 2013
Correspondent accounts with other banks	40,117,718	39,119,872
Loans and time deposits with other banks	2,030,667	2,000,208
Restricted deposits	<u>624,227</u>	<u>1,800,878</u>
	42,772,612	42,920,958
Less: allowance for impairment losses	(427,724)	(40,000)
<b>Total due from banks</b>	<b><u>42,344,888</u></b>	<b><u>42,880,958</u></b>

As at 31 December 2014 and 2013 accrued interest income included in due from banks amounted to AZN 30,667 and AZN 208, respectively.

Movements in allowances for impairment losses on balances due from banks for the years ended 31 December 2014 and 2013 are disclosed in Note 5.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

As at 31 December 2014 and 2013 the maximum credit risk exposure of due from banks amounted to AZN 42,344,888 and AZN 42,880,958, respectively.

As at 31 December 2014 and 2013 the Bank had restricted deposits blocked in support of guarantees issued and plastic cards operations and money transfers totaling AZN 624,227 and AZN 1,800,878, respectively.

#### 14. Loans to Customers

Loans to customers comprise:

	31 December 2014	31 December 2013
Loans to customers	1,082,546,861	1,016,598,441
Less allowance for impairment losses	<u>(46,295,570)</u>	<u>(30,586,436)</u>
<b>Total loans to customers</b>	<b><u>1,036,251,291</u></b>	<b><u>986,012,005</u></b>

As at 31 December 2014 and 2013 accrued interest income included in loans to customers amounted to AZN 24,946,241 and AZN 19,831,279, respectively.

Movements in allowances for impairment losses for the years ended 31 December 2014 and 2013 are disclosed in Note 5.

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

	31 December 2014	31 December 2013
Loans collateralized by real estate	386,122,909	320,178,265
Loans collateralized by cash	366,879,411	290,012,524
Loans collateralized by guarantees	164,869,775	166,858,114
Loans collateralized by equipment	72,154,884	64,185,642
Loans collateralized by vehicles	22,950,624	28,298,218
Loans collateralized by trade receivable	8,902,280	26,826,574
Loans collateralized by shares of other entities	-	2,506,464
Unsecured loans	<u>60,666,978</u>	<u>117,732,640</u>
	1,082,546,861	1,016,598,441
Less allowance for impairment losses	<u>(46,295,570)</u>	<u>(30,586,436)</u>
<b>Total loans to customers</b>	<b><u>1,036,251,291</u></b>	<b><u>986,012,005</u></b>



## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

Analysis by industry	31 December 2014	31 December 2013
Construction	341,643,877	311,822,014
Individuals	270,147,280	139,925,378
Mining	143,585,715	135,365,475
Energy	101,039,513	217,301,903
Manufacturing	98,254,534	100,010,819
Transportation and communication	73,289,972	65,209,718
Agriculture	33,222,332	21,934,182
Trading	7,286,589	1,199,872
Other	14,077,049	23,829,080
	<u>1,082,546,861</u>	<u>1,016,598,441</u>
Less allowance for impairment losses	<u>(46,295,570)</u>	<u>(30,586,436)</u>
<b>Total loans to customers</b>	<b><u>1,036,251,291</u></b>	<b><u>986,012,005</u></b>

Loans to individuals comprise the following products:

	31 December 2014	31 December 2013
Mortgage loans	167,076,699	62,714,888
Consumer loans	75,259,188	45,791,379
Car loans	20,831,325	24,934,015
Business loans	5,613,516	5,520,372
Plastic cards	1,366,552	964,724
	<u>270,147,280</u>	<u>139,925,378</u>
Less allowance for impairment losses	<u>(9,269,403)</u>	<u>(8,058,181)</u>
<b>Total loans to customers</b>	<b><u>260,877,877</u></b>	<b><u>131,867,197</u></b>

As at 31 December 2014 and 2013 the Bank granted 10 and 8 loans totaling AZN 608,090,435 and AZN 602,030,870, respectively, which individually exceeded 10% of the Group's equity.

As at 31 December 2014 and 2013 the maximum credit risk exposure of loans to customers amounted to AZN 1,036,251,291 and AZN 986,012,005, respectively.

As at 31 December 2014 and 2013 loans to customers included loans in amount of AZN 247,753,282 and AZN 47,872,248, respectively, whose terms have been renegotiated. Otherwise these loans would be past due or impaired.

As at 31 December 2014 and 2013 loans to customers included loans in amount of AZN 719,890,921 and AZN 632,253,533, respectively, that were individually determined to be impaired.

As at 31 December 2014 and 2013 59% and 60% of total amount of loans to customers are given to 11 and 8 entities, respectively.

A significant amount of loans (100% of loans to customers) is granted to companies operating in the Republic of Azerbaijan, which represents significant geographical concentration in one region.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### 15. Investments Available-for-Sale

Investments available-for-sale comprise:

	31 December 2014	31 December 2013
Debt securities	22,380,000	55,036,392
Equity securities	<u>177,181</u>	<u>177,469</u>
<b>Total investments available-for-sale</b>	<b><u>22,557,181</u></b>	<b><u>55,213,861</u></b>

As at 31 December 2014 and 2013 accrued interest income included in investments available for sale amounted to AZN 142,492 and AZN 1,010,392, respectively.

Equity securities	Share %	31 December 2014	Share %	31 December 2013
Baku Stock Exchange	5	135,000	5	135,000
Millikart LTD	1	40,000	1	40,000
SWIFT SCRL		<u>2,181</u>		<u>2,469</u>
<b>Total equity securities</b>		<b><u>177,181</u></b>		<b><u>177,469</u></b>

Debt securities	Nominal interest rate	31 December 2014	Nominal Interest rate	31 December 2013
Notes issued by Azerbaijan Mortgage Fund	3.00	19,995,659	3.13	55,036,392
Notes issued by resident banks	10.20	<u>2,509,833</u>	-	<u>-</u>
		22,505,492		55,036,392
Less: allowance for impairment losses		(125,492)		-
<b>Total debt securities</b>		<b><u>22,380,000</u></b>		<b><u>55,036,392</u></b>

# Open Joint Stock Company Xalq Bank

## Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

### 16. Premises, Equipment and Intangible Assets

	Land	Buildings	Computers	Vehicles	Furniture & Equipment	Other Equipment	Construction in progress	Total Premises & Equipment	Intangible Assets	Total
<b>Cost at 31 December 2012</b>	<u>886,332</u>	<u>67,572,761</u>	<u>3,090,027</u>	<u>3,114,649</u>	<u>7,191,118</u>	<u>780,680</u>	<u>1,639,960</u>	<b>84,275,527</b>	959,446	<b>85,234,973</b>
Additions	-	36,119	131,480	1,465,390	589,303	97,525	4,143,189	<b>6,463,006</b>	1,558,496	<b>8,021,502</b>
Disposals	-	(7,541)	(63,917)	(508,596)	(37,355)	-	(195)	<b>(617,604)</b>	(2,600)	<b>(620,204)</b>
Transfers	-	3,720,042	10,903	-	706,153	39,021	(4,476,119)	-	-	-
<b>Cost at 31 December 2013</b>	<u>886,332</u>	<u>71,321,381</u>	<u>3,168,493</u>	<u>4,071,443</u>	<u>8,449,219</u>	<u>917,226</u>	<u>1,306,835</u>	<b>90,120,929</b>	2,515,342	<b>92,636,271</b>
Additions	138,806	60,754	1,166,033	761,944	480,415	35,567	595,473	<b>3,238,992</b>	204,380	<b>3,443,372</b>
Disposals	-	-	(1,605)	(386,500)	-	(540)	(30,955)	<b>(419,600)</b>	-	<b>(419,600)</b>
Transfers	-	1,225,977	-	-	39,070	-	(1,265,047)	-	-	-
<b>Cost at 31 December 2014</b>	<u>1,025,138</u>	<u>72,608,112</u>	<u>4,332,921</u>	<u>4,446,887</u>	<u>8,968,704</u>	<u>952,253</u>	<u>606,306</u>	<b>92,940,321</b>	2,719,722	<b>95,660,043</b>
<b>Accumulated Depreciation at 31 December 2012</b>	<u>-</u>	<u>(2,761,319)</u>	<u>(1,804,969)</u>	<u>(1,755,053)</u>	<u>(3,816,863)</u>	<u>(290,495)</u>	<u>-</u>	<b>(10,428,699)</b>	(331,806)	<b>(10,760,505)</b>
Charge for the year	-	(2,206,281)	(468,785)	(603,234)	(1,332,367)	(111,812)	-	<b>(4,722,479)</b>	(256,203)	<b>(4,978,682)</b>
Disposals	-	-	63,097	454,452	35,290	-	-	<b>552,839</b>	259	<b>553,098</b>
Transfers	-	-	-	-	(100)	100	-	-	-	-
<b>Accumulated Depreciation at 31 December 2013</b>	<u>-</u>	<u>(4,967,600)</u>	<u>(2,210,657)</u>	<u>(1,903,835)</u>	<u>(5,114,040)</u>	<u>(402,207)</u>	<u>-</u>	<b>(14,598,339)</b>	(587,750)	<b>(15,186,089)</b>
Charge for the year	-	(2,404,622)	(308,916)	(833,056)	(1,491,901)	(121,881)	-	<b>(5,160,376)</b>	(257,085)	<b>(5,417,461)</b>
Disposals	-	-	-	174,910	-	-	-	<b>174,910</b>	-	<b>174,910</b>
Transfers	-	-	-	-	-	-	-	-	-	-
<b>Accumulated Depreciation at 31 December 2014</b>	<u>-</u>	<u>(7,372,222)</u>	<u>(2,519,573)</u>	<u>(2,561,981)</u>	<u>(6,605,941)</u>	<u>(524,088)</u>	<u>-</u>	<b>(19,583,805)</b>	(844,835)	<b>(20,428,640)</b>
<b>NBV at 31 December 2013</b>	<u>886,332</u>	<u>66,353,781</u>	<u>957,836</u>	<u>2,167,608</u>	<u>3,335,179</u>	<u>515,019</u>	<u>1,306,835</u>	<b>75,522,590</b>	<b>1,927,592</b>	<b>77,450,182</b>
<b>NBV at 31 December 2014</b>	<u>1,025,138</u>	<u>65,253,890</u>	<u>1,813,348</u>	<u>1,884,906</u>	<u>2,362,763</u>	<u>428,165</u>	<u>606,306</u>	<b>73,356,516</b>	<b>1,874,887</b>	<b>75,231,403</b>

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### 17. Investment Properties

Investment properties comprise:

	Year ended 31 December 2014	Year ended 31 December 2013
<b>Investment property at fair value at beginning of the year</b>	<u>6,691,512</u>	<u>6,374,800</u>
Fair value gains	2,207	316,712
<b>Investment properties at end of the year</b>	<u><u>6,693,719</u></u>	<u><u>6,691,512</u></u>

The fair value of investment property as at 31 December 2014 was determined on 29 December 2014 by AIS Azintellektservice, who holds a recognized professional qualification. The basis used for the appraisal was market value.

#### 18. Other Assets

Other assets comprise:

	31 December 2014	31 December 2013
Settlements on money transfers	2,607,871	1,620,453
Collateral repossessed	1,930,797	1,120,321
Prepayments for purchase of property and equipment	1,054,453	1,550,027
Prepayments and receivables on other transactions	681,518	605,754
Deferred expenses	632,070	717,267
Prepayments for purchases of intangible assets	253,619	15,533
Prepaid operating leases	138,535	156,035
Prepaid operating taxes	66,518	262,777
Accrued interest on other operations	-	7,500
Other	<u>1,009,038</u>	<u>4,625</u>
	8,374,419	6,060,292
Less: Provision for impairment of other non-financial assets	(918,276)	-
<b>Total other assets</b>	<u><u>7,456,143</u></u>	<u><u>6,060,292</u></u>

#### 19. Due to Banks and Government Agencies

Due to banks and government agencies comprise:

	31 December 2014	31 December 2013
Amount due to the National Fund for Support of Entrepreneurship	59,720,733	59,542,701
Amount due to Azerbaijan Mortgage Fund	42,915,602	38,312,321
Loans from Banks	39,220,000	39,225,000
Amount due to State Oil Company of Azerbaijan Republic	31,288,228	28,482,875
Loans from the CBAR	25,000,000	25,450,000
Correspondent accounts of other banks	3,985,679	4,017,158
Amount due to the National Depository Center	-	301,069
<b>Total due to banks and government agencies</b>	<u><u>202,130,242</u></u>	<u><u>195,331,124</u></u>

As at 31 December 2014 and 2013 accrued interest expense included in due to banks and government agencies amounted to AZN 149,059 and AZN 215,621, respectively.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### 20. Customer Accounts

Customer accounts comprise:

	31 December 2014	31 December 2013
Time deposits	627,364,569	547,139,696
Repayable on demand	<u>211,063,944</u>	<u>317,059,942</u>
<b>Total customer accounts</b>	<b><u>838,428,513</u></b>	<b><u>864,199,638</u></b>

As at 31 December 2014 and 2013 accrued interest expense included in customer accounts amounted to AZN 1,513,356 and AZN 1,222,293, respectively.

As at 31 December 2014 and 2013 customer accounts amounting to AZN 601,680,772 and AZN 577,395,176 were due to 11 and 9 customers representing a significant concentration, being approximately 72% and 67%, respectively.

	31 December 2014	31 December 2013
Individuals	640,471,906	600,130,240
Investing	97,812,164	166,992,136
Trade	35,192,632	14,931,759
Insurance	29,842,886	35,643,589
Construction	16,909,755	13,830,931
Entertainment	6,367,379	8,405,070
Transport and communication	6,185,161	9,672,962
Energy	2,967,605	10,338,165
Manufacturing	1,532,695	1,750,491
Financing	555,920	1,665,158
Agriculture	127,826	104,213
Other	<u>462,584</u>	<u>734,924</u>
<b>Total customer accounts</b>	<b><u>838,428,513</u></b>	<b><u>864,199,638</u></b>

#### 21. Other Liabilities

Other liabilities comprise:

	31 December 2014	31 December 2013
Settlements on money transfers and plastic cards	1,964,006	975,746
Payables to the employees	1,694,034	1,157,191
Payables to the Deposit Insurance Fund	396,455	601,957
Deferred revenue	364,372	349,627
Taxes other than income tax	210,998	902,644
Professional fees payable	51,570	39,530
Accrued expenses	45,078	94,107
Other	<u>291,360</u>	<u>146,251</u>
<b>Total other liabilities</b>	<b><u>5,017,873</u></b>	<b><u>4,267,053</u></b>

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### 22. Share Capital

As of 31 December 2014 and 2013 the Group's shareholders' authorized, issued and fully paid capital amounted to AZN 197,125,290 and AZN 183,693,180, respectively and comprised 3,630,300 and 3,630,300 ordinary shares with a par value of AZN 54.30 and AZN 50.60, respectively. Each share entitles one vote to the shareholder.

During 2014 and 2013 share capital of the Group was increased by AZN 13,432,110 and AZN 14,593,806, respectively.

During 2014 and 2013 par value of ordinary shares of the Group was increased by AZN 3.70 and AZN 4.02, respectively.

#### 23. Financial Commitments and Contingencies

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

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

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

Provision for losses on contingent liabilities amounted to AZN 211,331 and AZN 4,373,713 as at 31 December 2014 and 2013, respectively.

As at 31 December 2014 and 2013, the nominal or contract amounts and the risk amounts were:

	31 December 2014		31 December 2013	
	Nominal Amount	Risk Weighted Amount	Nominal Amount	Risk Weighted Amount
<b>Contingent liabilities and credit commitments</b>				
Guarantees issued and similar commitments	22,289,466	22,289,466	44,394,077	44,394,077
Letters of credit and other transaction related contingent obligations	1,078,312	539,156	8,300,072	4,150,036
Commitments on credits and unused credit lines	<u>51,215,666</u>	<u>25,607,833</u>	<u>45,260,204</u>	<u>22,630,102</u>
<b>Total contingent liabilities and credit commitments</b>	<b><u>74,583,444</u></b>	<b><u>48,436,455</u></b>	<b><u>97,954,353</u></b>	<b><u>71,174,215</u></b>

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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**Capital commitments** – The Group had no material commitments for capital expenditures outstanding as at 31 December 2014.

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

The Group is receiving claims from individual customers with respect to certain commissions withheld by the Group for loan agreements service. Management is of the opinion that such claims would not have adverse consequences for the Group, and is in the process of establishing procedures on disclosing additional information in loan agreements in compliance with the CBAR instruction.

**Taxes** - Azerbaijan 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 Group 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 Group has already made all tax payments that are due, and therefore no provisions have been made in these consolidated 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 31 December 2014 the Group was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

**Operating environment** - The Group's principal business activities are within Azerbaijan. Laws and regulations affecting the business environment in Azerbaijan are subject to rapid changes and the Group's assets and operations could be at risk due to negative changes in the political and business environment.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### 24. Transactions with Related Parties

Related parties or transactions with related parties in the Group, 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 Group (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Group that gives them significant influence over the Group; and that have joint control over the Group;
- (b) Associates – enterprises in which the Group has significant influence and which is neither a subsidiary nor a joint venture of the investor;
- (c) Members of key management personnel of the Group 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 significant voting power in such entity resides with, directly or indirectly, any individual referred to in (c) or (d).

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Group had the following transactions outstanding as at 31 December 2014 and 2013 with related parties:

	31 December 2014		31 December 2013	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Loans to customers		1,082,546,861		1,016,598,441
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	20,000,000		-	
- <i>key management personnel of the entity</i>	782,423		72,897	
Allowance for impairment losses		(46,295,570)		(30,586,436)
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	(200,000)		-	
- <i>key management personnel of the entity</i>	(7,824)		(2,131)	
Customer accounts		838,428,513		864,199,638
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	61,706,723		72,346,751	
- <i>key management personnel of the entity</i>	394,346		270,084	
Guarantees issued		22,289,466		44,394,077
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	2,297,870		1,185,800	
Unused loan commitments		51,215,666		45,260,204
- <i>key management personnel of the entity</i>	81,378		47,829	



## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

	Year ended 31 December 2014		Year ended 31 December 2013	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
<b>Key management personnel compensation:</b>				
short-term employee benefits	460,311	14,045,837	453,644	11,289,523

Included in the consolidated income statement for the years ended 31 December 2014 and 2013 are the following amounts which arose due to transactions with related parties:

	Year ended 31 December 2014		Year ended 31 December 2013	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Interest income		86,998,421		77,118,762
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	1,203,056		-	
- <i>key management personnel of the entity</i>	46,979		19,371	
Interest expense		(35,876,504)		(32,763,626)
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	(3,087,167)		(3,638,866)	
- <i>key management personnel of the entity</i>	(26,071)		(11,807)	
Fee and commission income		4,488,248		4,909,466
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	122,590		66,985	
- <i>key management personnel of the entity</i>	-		-	
Other income		416,827		841,447
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	356,604		366,519	
Operating expense		(27,446,922)		(24,427,778)
- <i>shareholders and entities in which a substantial interest is owned by shareholders of the Group</i>	(495,807)		(457,963)	

## 25. Segment Reporting

The Group's activity is sufficiently integrated and primarily relates to the banking sector. Accordingly, for purposes of IAS 14 "Segment reporting" the Group is accounted for as a single segment. The Group's assets are located in the Republic of Azerbaijan and major parts of its revenue and net profit arrives from operations in the Republic of Azerbaijan. The Group's operations include transactions with banks, legal entities and individuals. Data on other transaction balances and their results are provided in the respective notes to the consolidated financial statements.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### 26. Fair Value of Financial Instruments

Estimated fair value disclosures of financial instruments are made in accordance with the requirements of IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement". 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 Group could realize in a market exchange from the sale of its full holdings of a particular instrument.

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

	31 December 2014		31 December 2013	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash and cash equivalents	56,709,157	56,709,157	83,808,518	83,808,518
Due from banks	42,344,888	42,344,888	42,880,958	42,880,958
Due to banks and government agencies	202,130,242	202,130,242	195,331,124	195,331,124
Customer accounts	838,428,513	838,428,513	864,199,638	864,199,638

The fair value of loans to customers cannot be measured reliably as it is not practicable to obtain market information or apply any other valuation techniques on such instruments.

The fair value of equity securities included in investments available-for-sale cannot be measured reliably. As at 31 December 2014 and 2013 the cost of them was 177,181 and AZN 177,469, respectively. Since these shares are not publicly traded and the range of reasonable fair value estimates is significant, it is not possible to estimate their fair value.

#### 27. Regulatory Matters

Quantitative measures established by regulation to ensure capital adequacy require the Group to maintain minimum amounts and ratios (as set forth in the table below) of total (12%) and tier 1 capital (6%) to risk weighted assets.

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

Weighting	Description of position
0%	Cash and cash equivalents
20%	Nostro in OECD
100%	Nostro in NON-OECD
20%	Loans and advances to banks for up to 1 year
100%	Loans and advances to customers
100%	Other assets
50%	Obligations and commitments on unused loans with the initial maturity of over 1 year
100%	Guarantees

As at 31 December 2014 the Group's total capital amount for Capital Adequacy purposes was AZN 206,780,963 and tier 1 capital amount was AZN 206,780,963 with ratios of 17% and 17%, respectively.

As at 31 December 2013 the Group's total capital amount for Capital Adequacy purposes was AZN 194,508,685 and tier 1 capital amount was AZN 194,508,685 with ratios of 16% and 16%, respectively.

In addition, the Group has to maintain a statutory capital adequacy ratio based on the Central Bank of Azerbaijan Republic requirements. During the years ended 31 December 2014 and 2013 the Group was in compliance with the minimum capital requirements imposed by the CBAR.

# Open Joint Stock Company Xalq Bank

## Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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### 28. Capital Management

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance.

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

The Group's overall capital risk management policy remains unchanged from 2013.

### 29. Risk Management Policies

Management of risk is fundamental to the banking business and is an essential element of the Group's operations. The main risks inherent to the Group's operations are those related to credit exposures, liquidity and market movements in interest rates and foreign exchange rates. A description of the Group's risk management policies in relation to those risks follows. The Group manages the following risks:

#### Credit risk

The Group 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 Group'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 experts of Credit Department. Daily risk management is performed by the Head of Credit Departments and Branch Credit Divisions.

The Group structures the level of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry (and geographical) segments. Limits on the level of credit risk by a borrower and a product (by industry sector, by region) are approved monthly (quarterly) by the Management Board. The exposure to any one borrower including banks and brokers is further restricted by sub-limits covering on and off-balance sheet exposures which are set by the Credit Committee. Actual exposures against limits are monitored daily.

Where appropriate, and in the case of most loans, the Group obtains collateral and corporate and personal guarantees but a significant portion is personal lending, where no such facilities can be obtained. Such risks are monitored on a continuous basis and subject to annual or more frequent reviews.

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

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### Maximum Exposure

The Groups maximum exposure to credit risk varies significantly and is dependant on both individual risks and general market economy risks. The following table presents the maximum exposure to credit risk of financial assets and contingent liabilities. For financial assets the maximum exposure equals to a carrying value of those assets prior to any offset or collateral. For financial guarantees and other contingent liabilities the maximum exposure to credit risk is the maximum amount the Group would have to pay if the guarantee was called on or in the case of commitments, if the loan amount was called on.

	31 December 2014			
	Maximum exposure	Net exposure after offset	Collateral Pledged	Net exposure after offset and collateral
Due from banks	42,344,888	42,344,888	-	42,344,888
Loans to customers	1,036,251,291	1,036,251,291	975,584,313	60,666,978
Investments available-for-sale	22,557,181	22,557,181	-	22,557,181

	31 December 2013			
	Maximum exposure	Net exposure after offset	Collateral Pledged	Net exposure after offset and collateral
Due from banks	42,880,958	42,880,958	-	42,880,958
Loans to customers	986,012,005	986,012,005	868,296,385	117,715,620
Investments available-for-sale	55,213,861	55,213,861	-	55,213,861

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.

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

	31 December 2014						
	AAA	AA	A	BBB	< BBB	Not rated	Total
Due from banks	-	39,858,463	-	-	879,441	1,606,984	42,344,888
Loans to customers	-	-	-	-	-	1,036,251,291	1,036,251,291
Investments available-for-sale	-	-	-	-	-	22,557,181	22,557,181

	31 December 2013						
	AAA	AA	A	BBB	< BBB	Not rated	Total
Due from banks	-	35,928,153	-	-	4,976,177	1,976,628	42,880,958
Loans to customers	-	-	-	-	-	986,012,005	986,012,005
Investments available-for-sale	-	-	-	-	-	55,213,861	55,213,861

The banking industry is generally exposed to credit risk through its financial assets and contingent liabilities. Credit risk exposure of the Group is concentrated within the Republic of Azerbaijan. The exposure is monitored on a regular basis to ensure that the credit limits and credit worthiness guidelines established by the Group's risk management policy are not breached. The Group enters into numerous transactions where the counterparties are not rated by international rating agencies.

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### Rating model

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

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

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

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

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

	Neither past due nor impaired	Financial assets past due but not impaired				31 December 2014	
		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	42,344,888	-	-	-	-	-	42,344,888
Loans to customers	292,919,063	-	-	-	-	743,332,228	1,036,251,291
Investments available-for-sale	22,557,181	-	-	-	-	-	22,557,181

	Neither past due nor impaired	Financial assets past due but not impaired				31 December 2013	
		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	42,880,958	-	-	-	-	-	42,880,958
Loans to customers	335,756,301	-	-	-	-	650,255,704	986,012,005
Investments available-for-sale	55,213,861	-	-	-	-	-	55,213,861

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### Geographical concentration

The Assets and Liabilities Management Committee exercises control over the risk in the legislation and regulatory arena and assess its influence on the Group's activity. This approach allows the Group to minimize potential losses from the investment climate fluctuations in the Republic of Azerbaijan. The Group's Management Board sets up country limits, which mainly applies to banks of the Commonwealth of Independent States and Baltic countries.

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

	The Republic of Azerbaijan	CIS countries	OECD countries	31 December 2014 Total
<b>ASSETS</b>				
Cash and cash equivalents	56,709,157	-	-	56,709,157
Gold	6,600,521	-	-	6,600,521
Due from banks	1,659,105	827,320	39,858,463	42,344,888
Loans to customers	1,036,251,291	-	-	1,036,251,291
Investments available for sale	22,555,000	-	2,181	22,557,181
Property and equipment	73,356,516	-	-	73,356,516
Investment property	6,693,719	-	-	6,693,719
Intangible assets	1,874,887	-	-	1,874,887
Deferred income tax asset	1,573,580	-	-	1,573,580
Other assets	7,333,852	24,566	97,725	7,456,143
<b>TOTAL ASSETS</b>	<b>1,214,607,628</b>	<b>851,886</b>	<b>39,958,369</b>	<b>1,255,417,883</b>
<b>LIABILITIES</b>				
Due to banks and government agencies	202,130,242	-	-	202,130,242
Customer accounts	838,428,513	-	-	838,428,513
Provision for impairment losses on other operations	211,331	-	-	211,331
Current income tax liability	974,074	-	-	974,074
Other liabilities	4,974,043	14,076	29,754	5,017,873
<b>TOTAL LIABILITIES</b>	<b>1,046,718,203</b>	<b>14,076</b>	<b>29,754</b>	<b>1,046,762,033</b>
<b>NET POSITION</b>	<b>167,889,425</b>	<b>837,810</b>	<b>39,928,615</b>	

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

	The Republic of Azerbaijan	CIS countries	OECD countries	31 December 2013 Total
<b>ASSETS</b>				
Cash and cash equivalents	83,808,518	-	-	83,808,518
Gold	6,831,161	-	-	6,831,161
Due from banks	6,638,296	314,509	35,928,153	42,880,958
Loans to customers	986,012,005	-	-	986,012,005
Investments available for sale	55,211,392	-	2,469	55,213,861
Property and equipment	75,522,590	-	-	75,522,590
Investment property	6,691,512	-	-	6,691,512
Intangible assets	1,927,592	-	-	1,927,592
Deferred income tax asset	1,003,798	-	-	1,003,798
Other assets	6,022,990	13,622	23,680	6,060,292
<b>TOTAL ASSETS</b>	<b>1,229,669,854</b>	<b>328,131</b>	<b>35,954,302</b>	<b>1,265,952,287</b>
<b>LIABILITIES</b>				
Due to banks and government agencies	195,331,124	-	-	195,331,124
Customer accounts	864,199,638	-	-	864,199,638
Provision for impairment losses on other operations	4,373,713	-	-	4,373,713
Current income tax liability	1,344,482	-	-	1,344,482
Other liabilities	4,266,491	235	327	4,267,053
<b>TOTAL LIABILITIES</b>	<b>1,069,515,448</b>	<b>235</b>	<b>327</b>	<b>1,069,516,010</b>
<b>NET POSITION</b>	<b>160,154,406</b>	<b>327,896</b>	<b>35,953,975</b>	

#### 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. In order to manage liquidity risk, the Group performs daily monitoring of expected future cash flows on clients' and banking operations, which is a part of the assets/liabilities management process. The Assets and Liabilities Management Committee 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 Group 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 Group anticipates that the cash flow will occur in a different period.

# Open Joint Stock Company Xalq Bank

## Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2014 Total
<b>ASSETS</b>								
Due from banks	8,00%	1,979,134	-	-	-	-	-	1,979,134
Loans to customers	6,90%	13,755,307	17,069,875	330,099,360	501,767,531	148,612,978	-	1,011,305,051
Investments available for sale	3,80%	19,737,508	-	2,500,000	-	-	-	22,237,508
Total interest bearing assets at fixed rates		35,471,949	17,069,875	332,599,360	501,767,531	148,612,978	-	1,035,521,693
Total interest bearing assets		35,471,949	17,069,875	332,599,360	501,767,531	148,612,978	-	1,035,521,693
Cash and cash equivalents		46,158,433	-	-	-	-	10,550,724	56,709,157
Gold		6,600,521	-	-	-	-	-	6,600,521
Due from banks		39,741,527	-	-	-	-	624,227	40,365,754
Loans to customers		21,792,550	-	-	-	-	3,153,690	24,946,240
Investments available for sale		132,659	-	9,833	-	-	177,181	319,673
Other assets		2,607,871	637,217	-	1,930,797	-	-	5,175,885
		<b>152,505,510</b>	<b>17,707,092</b>	<b>332,609,193</b>	<b>503,698,328</b>	<b>148,612,978</b>	<b>14,505,822</b>	<b>1,169,638,923</b>
<b>LIABILITIES</b>								
Due to banks and government agencies	3,06%	1,961,000	3,042	79,519,819	30,037,972	86,428,508	-	197,950,341
Customer accounts	4,78%	42,864,504	32,620,016	157,457,541	387,502,981	-	5,500,920	625,945,962
Total interest bearing liabilities at fixed rates		44,825,504	32,623,058	236,977,360	417,540,953	86,428,508	5,500,920	823,896,303
Total interest bearing liabilities		44,825,504	32,623,058	236,977,360	417,540,953	86,428,508	5,500,920	823,896,303
Due to banks and government agencies		4,179,901	-	-	-	-	-	4,179,901
Customer accounts		172,292,613	-	-	-	-	40,189,938	212,482,551
Current income tax liability		-	974,074	-	-	-	-	974,074
Other liabilities		2,405,539	262,568	2,349,766	-	-	-	5,017,873
Guarantees issued and similar commitments		412,768	2,748,303	8,852,961	10,275,434	-	-	22,289,466
Letters of credit and other transaction related contingent obligations		-	-	1,078,312	-	-	-	1,078,312
Commitments on credits and unused credit lines		1,580,329	1,670,042	24,355,858	23,457,437	152,000	-	51,215,666
		<b>225,696,654</b>	<b>38,278,045</b>	<b>273,614,257</b>	<b>451,273,824</b>	<b>86,580,508</b>	<b>45,690,858</b>	<b>1,121,134,146</b>
Liquidity gap		(73,191,144)	(20,570,953)	58,994,936	52,424,504	62,032,470		
Interest sensitivity gap for fixed rate instruments		(9,353,555)	(15,553,183)	95,622,000	84,226,578	62,184,470		
Interest sensitivity gap		(9,353,555)	(15,553,183)	95,622,000	84,226,578	62,184,470		
<b>Cumulative interest sensitivity gap</b>		<b>(9,353,555)</b>	<b>(24,906,738)</b>	<b>70,715,262</b>	<b>154,941,840</b>	<b>217,126,310</b>		



# Open Joint Stock Company Xalq Bank

## Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2013 Total
<b>ASSETS</b>								
Due from banks	12,00%	-	-	1,960,000	-	-	-	1,960,000
Loans to customers	7,48%	27,056,431	9,995,251	243,318,408	533,606,224	152,204,412	-	966,180,726
Investments available for sale	3,13%	-	49,011,000	-	-	5,015,000	-	54,026,000
Total interest bearing assets at fixed rates		27,056,431	9,995,251	245,278,408	533,606,224	152,204,412	-	968,140,726
Total interest bearing assets		27,056,431	9,995,251	245,278,408	533,606,224	152,204,412	-	968,140,726
Cash and cash equivalents		62,694,891	-	-	-	-	21,113,627	83,808,518
Gold		6,831,161	-	-	-	-	-	6,831,161
Due from banks		39,120,080	-	-	-	-	1,800,878	40,920,958
Loans to customers		6,802,683	-	-	-	-	13,028,596	19,831,279
Investments available for sale		-	926,030	84,362	-	-	177,469	1,187,861
Other assets		1,627,953	721,892	-	1,120,321	-	-	3,470,166
		<b>144,133,199</b>	<b>11,643,173</b>	<b>245,362,770</b>	<b>534,726,545</b>	<b>152,204,412</b>	<b>36,120,570</b>	<b>1,124,190,669</b>
<b>LIABILITIES</b>								
Due to banks and government agencies	3,15%	-	100,548	72,106,104	44,146,702	74,744,991	-	191,098,345
Customer accounts	4,71%	23,736,878	166,521,242	102,996,104	252,789,163	-	-	546,043,387
Total interest bearing liabilities at fixed rates		23,736,878	166,621,790	175,102,208	296,935,865	74,744,991	-	737,141,732
Total interest bearing liabilities		23,736,878	166,621,790	175,102,208	296,935,865	74,744,991	-	737,141,732
Due to banks and government agencies		4,232,779	-	-	-	-	-	4,232,779
Customer accounts		263,989,869	-	-	-	-	54,166,382	318,156,251
Current income tax liability		-	1,344,482	-	-	-	-	1,344,482
Other liabilities		1,671,810	942,174	1,653,069	-	-	-	4,267,053
Guarantees issued and similar commitments		150,775	38,598,275	5,625,027	20,000	-	-	44,394,077
Letters of credit and other transaction related contingent obligations		2,917,773	280,067	4,603,182	499,050	-	-	8,300,072
Commitments on credits and unused credit lines		1,987,367	9,010,825	6,440,182	18,392,022	9,429,810	-	45,260,206
		<b>298,687,251</b>	<b>216,797,613</b>	<b>193,423,668</b>	<b>315,846,937</b>	<b>84,174,801</b>	<b>54,166,382</b>	<b>1,163,096,652</b>
Liquidity gap		(154,554,052)	(205,154,440)	51,939,102	218,879,608	68,029,611		
Interest sensitivity gap for fixed rate instruments		3,319,553	(156,626,539)	70,176,200	236,670,359	77,459,421		
Interest sensitivity gap		3,319,553	(156,626,539)	70,176,200	236,670,359	77,459,421		
<b>Cumulative interest sensitivity gap</b>		<b>3,319,553</b>	<b>(153,306,986)</b>	<b>(83,130,786)</b>	<b>153,539,573</b>	<b>230,998,994</b>		

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### Market Risk

Market risk covers interest rate risk, currency risk and other pricing risks to which the Group is exposed. There have been no changes as to the way the Group measures risk or to the risk it is exposed in 2013.

The Group is exposed to interest rate risks as entities in the Group borrow funds at both fixed and floating rates. The risk is managed by the Group maintaining an appropriate mix between fixed and floating rate borrowings.

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

The majority of the Group's loan contracts and other financial assets and liabilities that bear interest are either variable or contain clauses enabling the interest rate to be changed at the option of the lender. The Group monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

#### Interest rate risk

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

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

Impact on profit before tax:

	As at 31 December 2014		As at 31 December 2013	
	Interest rate	Interest rate	Interest rate	Interest rate
	+1%	-1%	+1%	-1%
<b>Assets:</b>				
Due from banks	19,791	(19,791)	19,600	(19,600)
Loans to customers	10,113,050	(10,113,050)	9,661,807	(9,661,807)
Investments available-for-sale	222,375	(222,375)	540,260	(540,260)
<b>Liabilities:</b>				
Due to banks and government agencies	(1,979,503)	1,979,503	(1,910,983)	1,910,983
Customer accounts	(6,259,460)	6,259,460	(5,460,434)	5,460,434
<b>Net impact on profit before tax</b>	<b>2,116,254</b>	<b>(2,116,254)</b>	<b>2,850,250</b>	<b>(2,850,250)</b>

Impact on shareholders' equity:

	As at 31 December 2014		As at 31 December 2013	
	Interest rate	Interest rate	Interest rate	Interest rate
	+1%	-1%	+1%	-1%
<b>Assets:</b>				
Due from banks	19,791	(19,791)	19,600	(19,600)
Loans to customers	10,113,050	(10,113,050)	9,661,807	(9,661,807)
Investments available-for-sale	222,375	(222,375)	540,260	(540,260)
<b>Liabilities:</b>				
Due to banks and government agencies	(1,979,503)	1,979,503	(1,910,983)	1,910,983
Customer accounts	(6,259,460)	6,259,460	(5,460,434)	5,460,434
<b>Net impact on profit before tax</b>	<b>2,116,254</b>	<b>(2,116,254)</b>	<b>2,850,250</b>	<b>(2,850,250)</b>

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

#### 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 Group 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. These limits also comply with the minimum requirements of the CBAR. The Group's exposure to foreign currency exchange rate risk is presented in the table below:

	AZN	USD	EUR	Other currency	31 December 2014 Total
<b>ASSETS</b>					
Cash and cash equivalents	25,041,972	3 247,557	28,419,628	-	56,709,157
Gold	-	-	-	6,600,521	6,600,521
Due from banks	10,716,240	1,738,708	28,620,504	1,269,436	42,344,888
Loans to customers	669,767,931	293,412,570	10,288,951	62,781,839	1,036,251,291
Investments available for sale	22,555,000	-	2,181	-	22,557,181
Property and equipment	73,356,516	-	-	-	73,356,516
Investment property	6,693,719	-	-	-	6,693,719
Intangible assets	1,874,887	-	-	-	1,874,887
Deferred income tax asset	1,573,580	-	-	-	1,573,580
Other assets	6,472,978	910,464	68,120	4,581	7,456,143
<b>TOTAL ASSETS</b>	<b>818,052,823</b>	<b>299,309,299</b>	<b>67,399,384</b>	<b>70,656,377</b>	<b>1,255,417,883</b>
<b>LIABILITIES</b>					
Due to banks and government agencies	131,622,014	70,508,228	-	-	202,130,242
Customer accounts	501,063,788	205,920,860	67,429,525	64,014,340	838,428,513
Provision for impairment losses on other operations	211,331	-	-	-	211,331
Current income tax liability	974,074	-	-	-	974,074
Other liabilities	3,024,755	1,903,623	71,650	17,845	5,017,873
<b>TOTAL LIABILITIES</b>	<b>636,895,962</b>	<b>278,332,711</b>	<b>67,501,175</b>	<b>64,032,185</b>	<b>1,046,762,033</b>
<b>OPEN BALANCE SHEET POSITION</b>	<b>181,156,861</b>	<b>20,976,588</b>	<b>(101,791)</b>	<b>6,624,192</b>	

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

	AZN	USD	EUR	Other currency	31 December 2013 Total
<b>ASSETS</b>					
Cash and cash equivalents	62,916,374	5,823,745	15,065,568	2,831	83,808,518
Gold	6,831,161	-	-	-	6,831,161
Due from banks	11,297,629	13,419,662	17,893,037	270,630	42,880,958
Loans to customers	726,624,874	259,156,985	230,146	-	986,012,005
Investments available for sale	55,211,392	-	2,469	-	55,213,861
Property and equipment	75,522,590	-	-	-	75,522,590
Investment property	6,691,512	-	-	-	6,691,512
Intangible assets	1,927,592	-	-	-	1,927,592
Deferred income tax asset	1,003,798	-	-	-	1,003,798
Other assets	5,455,334	527,789	73,508	3,661	6,060,292
<b>TOTAL ASSETS</b>	<b>953,482,256</b>	<b>278,928,181</b>	<b>33,264,728</b>	<b>277,122</b>	<b>1,265,952,287</b>
<b>LIABILITIES</b>					
Due to banks and government agencies	123,606,091	71,709,773	15,260	-	195,331,124
Customer accounts	623,944,405	206,449,362	33,788,195	17,676	864,199,638
Provision for impairment losses on other operations	4,373,713	-	-	-	4,373,713
Current income tax liability	1,344,482	-	-	-	1,344,482
Other liabilities	3,537,515	594,579	125,379	9,580	4,267,053
<b>TOTAL LIABILITIES</b>	<b>756,806,206</b>	<b>278,753,714</b>	<b>33,928,834</b>	<b>27,256</b>	<b>1,069,516,010</b>
<b>OPEN BALANCE SHEET POSITION</b>	<b>196,676,050</b>	<b>174,467</b>	<b>(664,106)</b>	<b>249,866</b>	

### Currency risk sensitivity

The following table details the Group's sensitivity to a 10% increase and decrease in the USD and Euro 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 Group where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

	As at 31 December 2014		As at 31 December 2013	
	AZN / USD +10%	AZN / USD -10%	AZN / USD +10%	AZN / USD -10%
Impact on profit or loss	2,097,659	(2,097,659)	17,447	(17,447)

	As at 31 December 2014		As at 31 December 2013	
	AZN / EURO +10%	AZN / EURO -10%	AZN / EURO +10%	AZN / EURO -10%
Impact on profit or loss	(10,179)	10,179	(66,411)	66,411

## Open Joint Stock Company Xalq Bank

### Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Continued) (in Azerbaijan Manats)

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#### 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 analyses do not take into consideration that the Group's assets and liabilities are actively managed. Additionally, the financial position of the Group may vary at the time that any actual market movement occurs. For example, the Group'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 consolidated 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 Group'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.

#### 30. Subsequent Events

On 21 February 2015 the Management Board of the Central Bank of Azerbaijan Republic set Azerbaijan Manat (AZN) at 1.05 to the U.S. dollar. The AZN has been effectively pegged to the U.S. dollar at just over 0.78 AZN per U.S. dollar since mid - 2011. The decision of devaluation was taken in an attempt to launch additional stimuli to diversify the national economy, further boost its international competitiveness and export potential, and ensure strategic sustainability of the balance of payments and the country's international creditability. As the result of this decision the Group incurred the total loss of AZN 28,152,467.

On 18 March 2015 the Group has opened one more branch in Baku. This branch is regulated by the permission of the Central Bank of the Republic of Azerbaijan.