"A-Group Insurance Company" OJSC

Financial Statements
for the Year Ended 31 December 2012
and Independent Auditor’s Report

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Independent Auditor's Report

To the Shareholder and the Supervisory Board of "A-Group Insurance Company" OJSC

We have audited the accompanying financial statements of "A-Group Insurance Company" Open Joint Stock Company ("the Company") which comprise the statement of financial position as at 31 December 2012, and the statement of comprehensive income, statement of cash flows and statement of changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's 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 about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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.

Basis for Qualified Opinion

As explained in Notes 12 and 13 to the financial statements management has not stated buildings and investment property at revalued amounts, which constitutes a departure from the Company's accounting policy. The information needed to quantify the effects of this departure on the financial position and the financial performance of the Company is not reasonably determinable.

Qualified Opinion

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects, the financial position of "A-Group Insurance Company" Open Joint Stock Company as at 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

1 August 2013

Statement of Management's Responsibilities for the Preparation and Approval of the Financial Statements for the Year Ended 31 December 2012

The following statement, which should be read in conjunction with the independent auditor's responsibilities stated in the independent auditor's report, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditor in relation to the financial statements of "A-Group Insurance Company" OJSC ("the Company").

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Company as at 31 December 2012, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgments and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Preparing the financial statements on a going concern basis, unless it is inappropriate to presume that the Company 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 Company;
- Maintaining proper accounting records that disclose, with reasonable accuracy, the financial position of the Company, and which enable them to ensure that the financial statements of the Company comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Company; and
- Detecting and preventing fraud and other irregularities.

On behalf of the Company's management the financial statements for the year ended 31 December 2012 were authorised for issue on 1 August 2013 by:

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Anar Bayramov
Chairman of the Board

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Natavan Imamguliyeva
Chief Accountant

"A-Group Insurance Company" OJSC

Baku, Azerbaijan

	Note	2012	2011
ASSETS			
Cash and cash equivalents	6	1,954,857	559,383
Deposits with banks	7	8,638,227	5,982,019
Receivables	8	3,821,330	1,432,358
Prepayments	9	255,147	488,143
Reinsurance assets	10	2,241,925	1,109,111
Deferred acquisition costs	11	472,119	247,890
Property and equipment	12	1,771,557	1,839,650
Investment property	13	357,100	357,100
Deferred tax assets	14	10,423	-
Other assets		173,346	182,808
Total assets		**19,696,031**	**12,198,462**
LIABILITIES AND EQUITY			
Liabilities			
Provision for unearned premiums	15	8,285,623	3,186,619
Provision for claims	16	718,017	739,018
Payables	17	2,436,084	1,216,519
Deferred commission income	18	477,811	273,051
Taxes payable		83,158	46,075
Deferred tax liabilities	14	-	363,451
Other liabilities		13,585	29,020
Total liabilities		**12,014,278**	**5,853,753**
Equity			
Share capital	19	4,719,750	2,906,250
Revaluation reserve		2,184,860	2,214,068
Retained earnings		777,143	1,224,391
Total equity		**7,681,753**	**6,344,709**
Total liabilities and equity		**19,696,031**	**12,198,462**

Anar Bayramov
Chairman of the Board

Natavan Imamguliyeva
Chief Accountant

1 August 2013

	Note	2012	2011
Gross premiums written	20	14,094,644	8,139,217
Premiums ceded	20	(2,289,426)	(1,132,143)
Change in provision for unearned premiums, net	20	(4,007,713)	(134,654)
Net premiums earned		**7,797,505**	**6,872,420**
Claims paid	20	(6,216,751)	(5,433,492)
Claims ceded	20	520,773	267,460
Change in provision for claims, net	20	62,523	838,260
Claims incurred, net		**(5,633,455)**	**(4,327,772)**
Net acquisition costs	21	(125,252)	(286,984)
Operating expenses	22	(1,054,895)	(984,993)
Provision for doubtful receivables	8	(265,734)	-
Interest income	23	641,713	510,926
Other income/(loss)	24	71,258	42,569
Profit before tax		**1,431,140**	**1,826,166**
Income tax charge	14	(64,888)	(371,685)
Net profit for the year		**1,366,252**	**1,454,481**
Other comprehensive income			
Revaluation of premises and equipment		(36,510)	(36,510)
Income tax relating to components of other comprehensive income		7,302	7,302
Other comprehensive loss for the year, net of tax		**(29,208)**	**(29,208)**
Total comprehensive income for the year		**1,337,044**	**1,425,273**
Earnings per share (basic and diluted)	19	176.29	187.67

Anar Bayramov
Chairman of the Board

Natavan Imamguliyeva
Chief Accountant

1 August 2013

	Note	2012	2011
Cash flows from operating activities			
Premiums received		11,631,769	8,648,270
Premiums paid		(983,989)	(528,708)
Claims paid		(5,785,439)	(3,112,957)
Reinsurance benefits received		312,692	14,072
Operating expenses paid		(1,099,227)	(3,520,053)
Commission paid		(597,329)	(201,293)
Other income received		29,386	37,186
Net cash flow from operating activities		**3,507,863**	**1,336,517**
Cash flows from investing activities			
Investment in deposits with banks		(2,060,190)	(1,835,708)
Acquisition of property and equipment	12	(62,950)	(21,475)
Proceeds from disposal of property and equipment		11,134	-
Net cash flow from investing activities		**(2,112,006)**	**(1,857,183)**
Effect of exchange rate differences		(383)	(4,067)
Net increase/(decrease) in cash and cash equivalents		1,395,474	(524,733)
Cash and cash equivalents at the beginning of the year	6	559,383	1,084,116
Cash and cash equivalents at the end of the year	**6**	**1,954,857**	**559,383**

Anar Bayramov
Chairman of the Board

Natavan Imamguliyeva
Chief Accountant

1 August 2013

	Share capital	Revaluation reserve	Retained earnings	Total
31 January 2011	**2,650,500**	**2,243,276**	**25,660**	**4,919,436**
Increase in share capital	255,750	-	(255,750)	-
Net profit for the year	-	-	1,454,481	1,454,481
Other comprehensive loss for the year, net of tax	-	(29,208)	-	(29,208)
31 December 2011	**2,906,250**	**2,214,068**	**1,224,391**	**6,344,709**
Increase in share capital	1,813,500		(1,813,500)	-
Net profit for the year	-	-	1,366,252	1,366,252
Other comprehensive loss for the year, net of tax	-	(29,208)	-	(29,208)
31 December 2012	**4,719,750**	**2,184,860**	**777,143**	**7,681,753**

Anar Bayramov
Chairman of the Board

Natavan Imamguliyeva
Chief Accountant

1 August 2013

1. Principal Activities of the Company

"A-Group Insurance Company" Open Joint Stock Company ("the Company") was set up in the Republic of Azerbaijan in 1995 as "Gruppa A" Limited Liability Insurance Company. In January 2009 the Company was re-registered as an open joint-stock company. The Company in principally engaged in rendering non-life insurance and reinsurance services. The Company operates under the insurance license issued by the Ministry of Finance of the Azerbaijan Republic. Insurance business covered by the Company includes, but is not limited to, medical, cargo, property, casualty, third party liability, vehicle and reinsurance.

The Company's registered office is at 172, L. Tolstoy Street, Baku, Azerbaijan, where its headquarter is located. The Company has one branch in Ganja.

The sole owner and the ultimate controlling party of the Company is Mr. Sabir Adnayev, an Azerbaijani national.

The average number of the Company's employees at the end of 2012 was 50 (2011: 54).

2. Operating Environment of the Company

General

Over recent years Azerbaijan has undergone substantial political and economic changes. As an emerging market, Azerbaijan does not possess a well-developed commercial infrastructure, which generally exists in more mature business markets. Laws and regulations affecting businesses operating within the country are subject to rapid change. Emerging market characteristics include, in particular, inconvertibility of the national currency in most countries outside of Azerbaijan and relatively high inflation rates. The current Azerbaijani tax, currency and customs legislation is subject to varying interpretations and frequent changes. In addition, continued economic stability is dependent to a large extent on the effectiveness of fiscal and monetary measures taken by the government, regulatory developments, decisions of international lending organisations, and other actions beyond the Company's control.

The insurance sector in Azerbaijan is sensitive to adverse fluctuations caused by lack of confidence in the financial system as a whole, as well as in economic environment. From the beginning of September 2008 the economy experienced certain difficulties as a result of the global financial crisis, which include declining credibility of the financial sector accompanied by reductions in liquidity and significant decreases in equity and bond markets. The ongoing global liquidity crisis has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector and substantially higher interbank lending rates.

The uncertainties in the global financial market have also led to bank failures and bank rescues in the US, Western Europe and Russia. Such circumstances could affect the ability of the Company to obtain borrowings at terms and conditions similar to those applied to earlier transactions. Management is unable to predict all factors which could have an impact on the insurance sector of Azerbaijan and consequently what effect, if any, they could have on the financial position of the Company. Although recently there have been positive economic signs in Azerbaijan, the long-term prospects for the Azerbaijani economy remain uncertain. National economy is dependent on export of hydrocarbon resources. The future economic direction of Azerbaijan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory and political developments. As a result, the Company's assets and operations could be at risk resulting from any adverse changes in the political and business environment.

Financial market transactions

The international financial crisis has resulted in, among other things, global liquidity crunch, which led to contraction of the international and domestic capital market, lower liquidity levels across the banking sector and very high uncertainty in the domestic and foreign equity markets. Currently, it is impossible to fully assess the influence of the ongoing crisis or avoid its impact.

At present investors are re-evaluating their exposure to risks, which results in reduced or closed limits on transactions conducted in Azerbaijan, thereby adding to volatility. Such circumstances could affect the ability of the Company to obtain borrowings at terms and conditions similar to those applied to earlier transactions.

Borrowers and debtors of the Company may also be affected by the repercussions of the financial crisis, which could in turn impact their ability to meet their financial obligations to the Company. To the extent that information is available, management has adequately reflected the revised estimates of expected future cash flows in their impairment assessments. These financial statements do not include the adjustments associated with the impact of further deterioration in the liquidity of the financial markets and the increasing volatility in the currency and equity markets on the Company's financial position.

Inflation

In 2012 inflation in Azerbaijan dropped significantly. The official inflation indices for the last three years are given in the table below:

Year ended	Inflation for the period
31 December 2012	1.2%
31 December 2011	8.1%
31 December 2010	5.7%

Currency transactions

National currency of Azerbaijan – manat – is the main currency used within the country. Foreign currencies, in particular the US dollars and Euro, play a significant role in measuring economic parameters of many business transactions in Azerbaijan. The table below shows the exchange rates of Azerbaijani manat ("AZN") relative to US dollars ("USD") and Euro ("EUR"):

Date	USD	EUR
31 December 2012	0.7850	1.0377
31 December 2011	0.7865	1.0178

3. Basis of Presentation

General principles

These financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"). The Company maintains its accounting records in accordance with the applicable legislation of the Republic of Azerbaijan. These financial statements have been prepared on the basis of those accounting records and adjusted as necessary in order to comply, in all material respects, with IFRS.

Functional and presentation currency

These financial statements are presented in Azerbaijani manats being the Company's functional and presentation currency. AZN is the prevailing currency in the primary economic environment where the Company conducts its ordinary activities and in which majority of receipts from operating activities are retained.

Estimates and assumptions

The preparation of the financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as at the date of the financial statements preparation, and the reported amounts of revenues and expenses during the reporting period. Issues that require best estimate and are most significant for the financial statements are disclosed in Notes 10, 11, 12, 13, 14, 15, 16, and 18.

Going concern

These financial statements reflect the Company management's current assessment of the impact of the Azerbaijani business environment on the operations and the financial position of the Company. The future economic direction of Azerbaijan is largely dependent upon the effectiveness of measures undertaken by the Azerbaijani Government and other factors, including regulatory and political developments, which are beyond the Company's control. The Company's management cannot predict what impact these factors can have on the Company's financial position in future.

For prompt management of liquidity risk the Company regularly monitors external factors, which could influence the Company's liquidity level, and forecasted cash flows. For the medium- and long-term liquidity risk management the Company analyses maturity mismatches of assets and liabilities. To reduce its risk exposure the Company sets liquidity gap limits. The set limits are periodically reviewed to reflect the changes in external and internal environment.

Reclassification in prior year presentation

To make the presentation consistent with that of the current year the Company reclassified prior year payables in the amount of AZN 469,791, which were to be settled on a net basis, into receivables. These reclassification had no effect on the reported results of operations.

Changes in Accounting Policies

The accounting policies adopted are generally consistent with those of the previous financial year.

Listed below are those amended standards and interpretations which are or in the future could be relevant to the Company's operations:

- IFRS 1 "First-Time Adoption of International Financial Reporting Standards" Sever Hyperinflation (effective for annual periods beginning on or after 1 July 2011). The amendments provide guidance for entities emerging from sever hyperinflation either to resume presenting IFRS financial statements or to present IFRS financial statements for the first time.
- IFRS 1 "First-Time Adoption of International Financial Reporting Standards" Removal of Fixed Dates for First-time Adopter (effective for annual periods beginning on or after 1 July 2011). The amendments provide relief to the entities presenting their first IFRS financial statements from reconstructing transactions that occurred before their date of transition to IFRSs.
- IFRS 7 "Financial Instruments: Disclosures" Transfer of Financial Assets (effective for annual periods beginning on or after 1 July 2011). The amendments increase the disclosure requirements related to transfer of financial assets. These amendments are intended to provide greater transparency around risk exposure of transactions where a financial assets is transferred but the transferor retains some level of continuing exposure in the asset.
- IAS 12 "Income Taxes" Deferred Tax Recovery of Underlying Assets (effective for annual periods beginning on or after 1 January 2012). The amendments provide an exception to the general principle set out in IAS 12 Income Taxes that the measurement of deferred tax should reflect the manner in which an entity expects to recover the carrying amount of an asset. Specifically, the amendments establish a rebuttable presumption that the carrying amount of an investment property measured using the fair value model in IAS 40 Investment Property will be recovered entirely through sale. The amendments were issued in response to concerns that application of IAS 12's general approach can be difficult or subjective for investment property measured at fair value because it may be that the entity intends to hold the asset for an indefinite or indeterminable period of time, during which it anticipates both rental income and capital appreciation. Under the amendments, unless the presumption is rebutted, the measurement of deferred tax liability or deferred tax asset is required to reflect the tax consequences of recovering the carrying amount of an investment property entirely through sale. The 'sale' presumption is rebutted if the investment property is depreciable and the investment property is held within the business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time rather through sale. Following the application of amendments, entities holding investment property accounted for using fair value model in accordance with IAS 40 in jurisdiction where tax is not imposed on sale of investment property will no longer recognise deferred tax on any temporary differences arising from fair value gains or losses(unless the assumption is rebutted). This is because there would be no tax consequences expected to arise from recovering the carrying amount entirely through sale, regardless of whether any entity intends to use the property to generate rental income for a period of time prior to sale.

IFRSs and IFRIC interpretations not yet effective

The Company has not applied the following IFRSs and Interpretations of the International Financial Reporting Interpretations Committee (IFRIC) that have been issued but are not yet effective:

- IAS 27 "Separate Financial Statements" (effective for annual reporting periods beginning on or after 1 January 2013). This standard and IFRS 10 "Consolidated Financial Statements" supersede IAS 27 "Consolidated and Separate Financial Statements" (as amended in 2003). IAS 27 clarifies transition requirements regarding changes in IAS 21, 28 and 31 caused by revision of IAS 27 (as amended in January 2008). IAS 27 sets out requirements for accounting for and disclosure of information about an entity's investments in subsidiaries, joint ventures and associates when preparing separate financial statements.
- IAS 28 "Investments in Associates and Joint Ventures" (effective for annual reporting periods beginning on or after 1 January 2013). This standard is a revised version of IAS 28 "Investments in Associates" (as amended in 2003) and sets out requirements for the application of the equity method when accounting for investments in associates and joint ventures.

- IFRS 9 "Financial Instruments" (effective for annual reporting periods beginning on or after 1 January 2013; however, the date can be postponed to 1 January 2015; early adoption is permitted). This standard was issued in November 2009 as the first phase of replacing IAS 39 and replaces those parts of IAS 39 that relate to classification and measurement of financial assets. The second phase of replacing this standard regarding the classification and measurement of financial liabilities took place in October 2010. The main differences of the new standard are as follows:

  - financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

  - an instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent only payments of principal and interest (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss;

  - all equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

  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 as at fair value through profit or loss in other comprehensive income.

- IFRS 10 "Consolidated Financial Statements" (effective for annual reporting periods beginning on or after 1 January 2013). The new standard supersedes IAS 27 "Consolidated and Separate Financial Statements" and SIC 12 "Consolidation – Special Purpose Entities". IFRS 10 introduces a unified three-level control model: the investor can have control provided that the three criteria are met:

  (a) the investor has power over the investee;
  (b) the investor is exposed or has rights to variable returns from its involvement with that investee;
  (c) the investor has the ability to use its power over the investee to affect the amount of the investor's returns.

  Early adoption of IFRS 10 is permitted provided an entity also early adopts IFRS 11, IFRS 12, IAS 27 (as amended in 2011) and IAS 28 (as amended in 2011).

- IFRS 11 "Joint Arrangements" (applied retrospectively to annual reporting periods beginning on or after 1 January 2013). The new standard supersedes IAS 31 "Interests in Joint Ventures". The main change introduced by IFRS 11 relates to the classification of all types of joint arrangements into joint operations, which are accounted for on a proportionate consolidation basis, or joint ventures, for which the equity method is used. The type of joint arrangement is determined based on rights and obligations of the parties to the arrangement arising from joint arrangement's structure, legal form, contractual arrangement and other facts and circumstances. Early adoption of IFRS 11 is permitted provided an entity also early adopts IFRS 10, IFRS 12, IAS 27 (as amended in 2011) and IAS 28 (as amended in 2011).

- IFRS 12 "Disclosure of Interests in Other Entities" (effective for annual reporting periods beginning on or after 1 January 2013). The new standard contains disclosure requirements for entities that have interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. Interests in another entity are widely defined as contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. Additional and new requirements for disclosing information aim to provide the users of financial statements with information that would enable them to assess the nature of the risks related to the entity's interests in other entities and the effect of those interests on the entity's financial position, financial results and cash flows. In case of adopting IFRS 12 in an earlier reporting period in full, IFRS 10, IFRS 11, IAS 27 (as amended in 2011), and IAS 28 (as amended in 2011) should be also adopted.

- IFRS 13 "Fair Value Measurement" (applied prospectively for annual periods beginning on or after 1 January 2013; early application is permitted). The new standard replaces fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It provides a revised definition of fair value, establishes a framework for measuring fair value, and sets out disclosure requirements for fair value measurement. IFRS 13 does not introduce new requirements

for measurement of assets and liabilities at fair value nor does it eliminate the exceptions to fair value measurement currently applicable to certain standards.

- Amendment to IAS 1 “Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income” (applied retrospectively for annual periods beginning from 1 July 2012; early application is permitted). The amendment requires that an entity present separately items of other comprehensive income that may be reclassified to profit or loss in the future from those that will never be reclassified to profit or loss. Additionally, the amendment changes the title of the statement of comprehensive income to ‘statement of profit or loss and other comprehensive income’ (the use of other wording in the title is permitted).

- Amendment to IAS 19 “Employee Benefits” (applied retrospectively for annual periods beginning on or after 1 January 2013; early application is permitted). The amendment makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits. The amendment also makes significant changes to disclosures for all employee benefits.

- Amendment to IAS 32 “Financial Instruments: Presentation” Offsetting Financial Assets and Financial Liabilities and the related disclosure (applied retrospectively for annual periods beginning on or after 1 January 2014; early application is permitted). The amendments to IAS 32 clarify existing application issues relating to the offsetting requirements.

- Amendment to IFRS 1 “First-Time Adoption of International Financial Reporting Standards” Government Loans (applied retrospectively for annual periods beginning on or after 1 January 2013; early application is permitted). The amendments provide relief to the entities presenting their IFRS financial statements for the first time by amending IFRS 1 to allow prospective application of IAS 39 or IFRS 9 and paragraph 10A of IAS 20 “Accounting for Government Grants and Disclosure of Government Assistance” to government loans outstanding at the date of transition to IFRSs.

- Amendment to IFRS 7 “Financial Instruments: Disclosure” Offsetting Financial Assets and Financial Liabilities and the related disclosure (applied retrospectively for annual periods beginning on or after 1 January 2014; early application is permitted). The amendments to IFRS 7 require entities to disclose information about rights of offset and related arrangements (such as collateral posting requirements) for financial instruments under an enforceable master netting agreement or similar arrangement.

- IFRIC 20 “Stripping Costs in the Production Phase of a Surface Mine” (applied retrospectively for annual periods beginning on or after 1 January 2013; early application is permitted). IFRIC 20 applies to waste removal costs that are incurred in surface mining activity during the production phase of the mine (Production stripping costs). Under the interpretation, the costs from this waste removal activity (stripping) which provide improved access to ore is recognised as non-current asset (stripping activity assets) when certain criteria are met, whereas the costs of normal ongoing operational stripping activities are existing asset and classified as tangible or intangible according to the nature of the exiting asset of which it forms part.

Under the annual improvement the following standards were amended.

- IAS 1 Clarification of the requirements for the comparative information. The amendments to IAS 1 clarify that an entity is required to present a statement of financial position as at the beginning of the preceding period only when the retrospective application of an accounting policy, restatement or reclassification has a material effect on the information in the third statement of financial position and the related notes are not required to accompany the third statement of financial position.

- IAS 16 “Property Plant and Equipment”-Classification of servicing equipment. The amendments clarity that spare parts, stand-by equipment and servicing equipment should be classified as property, plant and equipment when they meet the definition of property plant and equipment in IAS 16 and as inventory otherwise.

- IAS 32 Tax effect of distribution to holders of equity instruments. The amendments clarify that income tax on distributions to holders of an equity instrument and on transaction costs of an equity transaction should be accounted for in accordance with IAS 12.

- IAS 34 “Interim Financial Reporting” Interim financial reporting and segment information for total assets and liabilities. The amendments clarify that the total assets and total liabilities for a particular reportable segment would be separately disclose in interim financial reporting only when the amounts are regularly provided to the chief operating decision maker and there has been a material change from the amounts disclosed in the last annual financial statements for that reportable segment.

- Amendment to IFRS 1 - Repeat application of IFRS 1. The amendments clarify that an entity may apply IFRS 1 if its most recent previous annual financial statement did not contain an explicit and unreserved statement of compliance with IFRSs, even if the entity applied IFRS in the past. An entity that does not elect to apply IFRS 1 must apply IFRSs retrospectively as if there was no interruption.

- Amendment to IFRS 1 - Borrowing costs. The amendments clarity that borrowing costs capitalised under previous GAAP before the date of transition to IFRSs may be carried forward without adjustment to the amount previously capitalised at the transition date. As for borrowing costs incurred on or after the date of transition to IFRSs that relate to the qualifying assets under construction at the date of transitions, the amendments clarify that they should be accounted for in accordance with IAS 23 “Borrowing Costs”.

Management believes that the application of other new and revised IFRSs will not have a material impact on the financial statements.

4. Summary of Significant Accounting Policies

Cash and cash equivalents

Cash and cash equivalents are assets, which can be converted into cash within a day and consist of cash on hand and current bank account balances of the Company, and other short-term highly liquid investments with original maturities of three months or less. Amounts, which relate to funds that are of a restricted nature, are excluded from cash and cash equivalents.

Financial assets

The Company classifies its financial assets in the following categories:

- loans and receivables;
- financial assets available for sale.

The Company determines the classification of its financial assets at initial recognition. Classification of financial assets at initial recognition depends on the purpose for which they were acquired and their characteristics.

Initial recognition of financial instruments

The Company recognises financial assets and financial liabilities in its statement of financial position when it becomes a party to the contractual obligation of the financial instrument. Regular way purchases and sales of the financial assets and liabilities are recognised using settlement date accounting.

All financial assets are initially recognised at fair value plus transaction costs that are directly attributable to acquisition or issue of the financial instrument.

Fair value measurement

The fair value of financial instruments traded on the active market as at the reporting date is determined based on the market or dealers’ quotations including transaction costs.

If a quoted market price is not available, the fair value of financial assets and financial liabilities recorded in the statement of financial position is estimated on the basis of market quotations for similar financial instruments or using various valuation techniques, including mathematical models. Where mathematical models are used, inputs are based on observable market data or judgment.

Judgment is based on such considerations as the time value of money, credit risk level, volatility of the instrument, market risk level and other applicable factors.

Impairment of financial assets

The Company assesses on each closing date whether there is any objective evidence that the value of a financial asset item or company of items has been impaired. Impairment losses are recognised in the statement of comprehensive income as they are incurred as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and has an impact on the amount or timing of the estimated future cash flows of the financial asset or company of financial assets that can be reliably estimated. If the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a company of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Derecognition of financial assets

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

- the rights to receive cash flows from the asset have expired;

- the Company has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party; and
- the Company either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset. If the transferee has no practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the transfer, the entity has retained control.

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

Deposits with banks

Deposits placed with banks are recognised when the Company issues cash to banks and has no intention to get involved in trading in non-derivative financial instruments not quoted in an active market and repayable on the fixed or determinable date. Deposits with banks are carried at amortised cost and recorded until repayment.

Insurance and investment contracts - classification

The Company enters into contracts which have insurance or financial risk, or both.

Insurance contracts are contracts where one party (the insurer) accepts a substantial insurance risk from the other party (the insured), agreeing to make payment to the insured upon occurrence in the future of the agreed unforeseen event (insured event) which had an adverse effect on the reinsured.

Such contracts are also exposed to financial risk.

Insurance risk arises when at least one of the following is uncertain at the inception of the insurance contract:

- whether an insured event will occur;
- when it will occur; or
- how much the insurer will need to pay if it occurs.

The Company does not consider the following risks as insurance risks:

- financial risk;
- risk that did not exist before the conclusion of the contract and resulted from its signing;
- risk of cancellation (prolongation) of the contract earlier than the issuer expected when determining the contract price;
- risk of unforeseen increase in administrative expenses related to the contract.

The Company classifies a contract as an insurance contract only if it cedes significant insurance risk.

Insurance risk is significant if, and only if, an insured event could cause the Company to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (i.e. have no discernible effect on the economics of the transaction).

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

Contracts that have a legal form of insurance, but contain financial risk with no significant insurance risk are investment contracts.

Contracts that have a legal form of insurance, but that do not imply the assumption of all significant insurance risks by the insurer and are not recognised as investment contracts are service contracts under IFRS.

The following IFRSs are applied in respect of a Company of contracts that have the legal form of insurance:

- insurance contracts – recognition and measurement are made in accordance with IFRS 4;
- investment contracts - recognition and measurement are made in accordance with IAS 39 "Financial Instruments: Recognition and Measurement".

Description of insurance products

The Company accepts for insurance the following insurance risks and portfolios:

- Insurance from fire;
- Vehicle insurance;
- Liability insurance;
- Travel insurance;
- Medical insurance;
- Construction insurance;
- Cargo insurance;
- Accident insurance;
- Borrower's insurance;
- Other insurance.

Non-Life Insurance

Insurance premiums. Premiums under insurance contracts are recorded as revenue on the date the insurance risk is assumed. The provision for unearned premiums is recognised on the same date and is subsequently recorded as income in proportion to the contract term.

Provision for unearned premiums. Provision for unearned premiums represents the portion of premiums written applicable to the unexpired term of the insurance contract as at the reporting date.

Claims adjustment expenses. Claims adjustment expenses are recorded in the statement of comprehensive income as incurred.

Provisions for claims. Provisions for claims are the estimated liability to settle future claims and include the provision for claims reported but not paid (RBNP) and provision for claims incurred but not reported (IBNR). The estimated claims adjustment expenses are included in RBNP and IBNR. RBNP is set up based on the claims that were reported but are still outstanding at the reporting date. The estimate is made on the basis of the information obtained by the Company when the insured events are considered, including information obtained subsequent to the reporting date. IBNR is actuarially estimated by the Company by each class of insurance business based on historical payment patterns for prior claims. The methods applied to estimate the provisions are regularly reviewed. The resulting adjustments are recorded in the statement of comprehensive income as they arise. The claims provision is estimated on an undiscounted basis, as the period between the claim filing and its settlement is rather short.

Unexpired risk provision. Unexpired risk provision is made for any deficiencies arising when unearned premiums are insufficient to meet expected claims and expenses to be borne by the Company after the end of the financial year under insurance contracts in effect at the reporting date. Unexpired risk provision is based upon loss development historical patterns and future loss projections (including claims adjustment expenses), and the level of expenses required to cover the current portfolio. Expected losses are calculated having regard to events that have occurred prior to the reporting date. For the financial reporting purposes the provision for unexpired risk is written off against deferred acquisition costs.

Reinsurance

The Company cedes reinsurance in the normal course of business. Reinsurance does not extinguish the Company's liability to its customers.

Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract. Reinsured assets comprise receivables from reinsurers on settled claims, including claims handling expenses, reinsurers' share of claims provision and deferred acquisition costs. Reinsurance payables are the Company's liabilities in respect of premiums payable for reinsurance.

The Company assesses its reinsurance assets for impairment on a regular basis using the same accounting policies adopted for financial assets held at amortised cost. If there is objective evidence that the reinsurance asset is impaired, the Company reduces the carrying amount of the reinsurance asset to its recoverable amount and recognises that impairment loss in the statement of comprehensive income.

Deferred commission income

Commission income represent commission associated with reinsurance business and is primarily related to the reinsurance of mandatory and voluntary insurance contracts. Commission income is deferred and

amortised over the contract period of reinsured policy. Commission income is estimated by each class of insurance.

Deferred acquisition costs ("DAC")

Acquisition costs represent commission expenses associated with obtaining insurance business and vary with and are primarily related to the acquisition of new and renewal insurance contracts. Acquisition costs are deferred and amortised over the period in which the related premiums are earned. Deferred acquisition costs are estimated by each class of insurance. At the time of policy issue and each reporting date, DAC are subject to recoverability testing by class of insurance based on future assumptions.

Acquisition costs on reinsurance, claim settlement and general and administrative expenses include personnel subsistence expenses, taxes other than income tax, depreciation, communication services, which are allocated among respective expense items subject to responsibilities of the Company's officials and in proportion to actual time spent.

Financial liabilities

Financial liabilities are classified as financial liabilities carried at amortised cost.

Initially, a financial liability shall be measured by the Company at its fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial liability.

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

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

Financial liabilities carried at amortised cost

Financial liabilities carried at amortised cost are payables to suppliers, taxes payable, and borrowed funds. Borrowed funds include regular and subordinated loans received by the Company and are recorded as cash is advanced to the Company.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and impairment provision, where required.

The Company's property is revalued on a regular basis. The frequency of revaluations depends on changes in the fair value of the assets subjected to revaluation. The revaluation reserve for property and equipment included in equity is transferred directly to retained earnings when the surplus is realised, i.e. either on the retirement or disposal of the asset, or as the asset is used by the Company. In the latter case, the amount of the surplus realised is the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost.

At each reporting date the Company assesses whether there is any indication of impairment of property and equipment. If any such indication exists, the Company estimates the recoverable amount, which is determined as the higher of an asset's net selling price and its value in use. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down to its recoverable amount and the decrease in the carrying amount is charged to the statement of comprehensive income to the extent it exceeds the previous revaluation surplus in equity. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's recoverable amount.

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are recorded within other expenses in the statement of comprehensive income.

Repairs and maintenance are charged to the statement of comprehensive income when the expense is incurred.

Construction in progress is carried at cost less impairment provision, where required. As soon as construction is completed, assets are reclassified as property and equipment at their carrying value at the date of reclassification. Construction in progress is not depreciated until the asset is available for use.

Depreciation

Depreciation of property and equipment commences from the date the assets are ready for use. Depreciation is charged on a straight-line basis over the following useful lives of the assets:

- Buildings – 22 years;
- Furniture – 5 years;
- Computers and office equipment – 4 years;
- Motor vehicles – 4 years.

The residual value of an asset is the estimated amount that the Company would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Intangible assets acquired separately

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

Investment property

Investment property is property held by the Company to earn rentals or for capital appreciation or both, rather than for: (a) use in the Company’s ordinary course of business, for administrative purposes; or (b) sale in the ordinary course of business.

Investment property is initially recorded at the cost of acquisition and subsequently remeasured to the fair value based on its market value. The market value of the Company’s investment property is obtained from reports of independent appraisers, who have recognised and relevant professional qualifications and experience in valuation of property of similar location and category. Changes in the fair value of investment property are recorded in the statement of comprehensive income as a separate line.

The Company records rentals in the statement of comprehensive income as gain/(loss) on revaluation of investment property. Direct operating expenses (including repair and maintenance) arising from investment property are recorded as incurred within other expenses relating to investment activity in the statement of comprehensive income.

If the investment property is used by the Company for its own operating activities, it is reclassified to premises and equipment, and its carrying amount at the date of reclassification becomes its deemed cost to be subsequently depreciated.

Property under construction and renovation intended for subsequent use as investment property is recorded as investment property.

Operating lease – the Company as a lessor

Leases of property under which the risks and rewards of ownership are effectively retained with the lessor are classified as operating leases. Lease payments under operating lease are recognised as income on a straight-line basis over the lease term and included into other income in the statement of comprehensive income.

Share capital

Statutory share capital is recorded at its nominal amount actually paid in in accordance with the Company’s constitution documents. Share capital contributions made in the form of assets other than cash are stated at their fair value at the date of contribution.

Dividends

Dividends are recognised when declared at the General Meeting of Shareholders of the Company.

Contingent assets and liabilities

Contingent assets are not recognised in the statement of financial position but disclosed in the financial statements when an inflow of economic benefits is probable.

Contingent liabilities are not recognised in the statement of financial position but disclosed in the financial statements unless the possibility of any outflow in settlement is remote.

Taxation

The income tax charge comprises current tax and deferred tax and is recorded in the statement of comprehensive income. Income tax expense is recorded in the financial statements in accordance with the applicable legislation of Azerbaijan. Current tax is calculated on the basis of the taxable profit for the year, using the tax rates enacted during the reporting period.

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current or prior periods. Tax amounts are based on estimates if financial statements are authorised prior to filing relevant tax returns.

Deferred income tax is provided using the balance sheet liability method for tax loss carryforwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax balances are measured at tax rates enacted or substantively enacted at the reporting date which are expected to apply to the period when the temporary differences will reverse or the tax loss carryforwards will be utilised. Deferred tax assets and liabilities are offset if there is a legally enforceable right to set off current tax assets against current tax liabilities. Deferred tax assets for deductible temporary differences and tax loss carryforwards are recorded to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised. Judgment is required to determine the amount of deferred tax assets that may be recognised in financial statements based on probable periods and amounts of future taxable profits and future tax planning strategies.

Azerbaijan also has various other taxes, which are assessed on the Company’s activities. These taxes are recorded within operating expenses in the statement of comprehensive income.

Income and expense recognition

Interest income and expense are recorded in the statement of comprehensive income for all debt instruments on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability 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 to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Company estimates cash flows considering all contractual terms of the financial instrument, but does not consider future credit losses. The calculation includes all commissions and fees paid or received by the parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts.

Interest income includes coupons earned on fixed-income financial assets and accrued discount and premium on promissory notes and other discounted instruments. When loans become doubtful of collection, they are written down to their recoverable amounts and interest income is thereafter recognised based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

Fees, commissions and other income and expense items are recorded on an accrual basis after the service is provided. Loan origination fees for loans that are not yet provided, but are probable of being drawn down, are recognised within other assets and are subsequently taken into account in calculation of effective yield on the loan. Fees and commissions arising from negotiating a transaction for a third party, such as the acquisition of loans, shares and other securities or the purchase or sale of businesses, are recorded on completion of the transaction in the statement of comprehensive income. Investment portfolio and other advisory service fees are recognised based on the applicable service contracts.

Employee benefits and social insurance contributions

The Company pays social security contributions in the territory of Azerbaijan. These contributions are recorded on an accrual basis. The Company does not have pension arrangements separate from the state pension system of Azerbaijan. Wages, salaries, contributions to the State Social Protection Fund, paid annual leaves and paid sick leaves, bonuses and non-monetary benefits are accrued as the Company’s employees render the related service.

Segment reporting

Operating segments are identified on the basis of internal reports about components of the Company that are regularly reviewed by the chief operating decision maker in order to allocate resources to the segment and to assess its performance. The Company's segmental reporting is based on types of insurance products.

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

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

If the total external revenue reported by operating segments constitutes less than 75 percent of the entity's revenue, additional operating segments are identified as reportable segments (even if they do not meet the quantitative thresholds set).

Foreign currency

Foreign currency transactions are translated into the functional currency at the Central Bank of the Republic of Azerbaijan exchange rate in effect at the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the Central Bank's exchange rate ruling at the reporting date. Foreign exchange gains and losses resulting from revaluation of transactions in foreign currency are recorded in the statement of comprehensive income within foreign exchange translation gains less losses. Non-monetary items denominated in foreign currency and carried at cost are restated at the Central Bank's exchange rate in effect at the transaction date. Non-monetary items denominated in foreign currency and carried at fair value are restated at the exchange rate in effect at the date the fair value is determined.

Gains and losses on purchase and sale of foreign currency are determined as the difference between the selling price and the carrying amount at the date of the transaction.

5. Critical Accounting Estimates and Judgments

The Company makes certain estimates and assumptions regarding the future. Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Reserves for claims

Loss reserves are particularly dependent on the use of estimates and judgment regarding the development of loss expectations. Reserves are calculated for individual lines of business, taking into consideration a wide range of factors. This reserving process begins with actuaries gathering data, typically dividing reserving data into the smallest possible homogeneous segments, while maintaining sufficient volume to form the basis for stable projections.

Once data is collected, they derive patterns of loss payment and emergence of claims based on historical data organised into development triangles arrayed by accident year versus development year. Loss payment and reporting patterns are selected based on observed historical development factors and also on the judgment of the reserving actuary using an understanding of the underlying business, claims processes, data and systems as well as the market, economic, societal and legal environment. Expected loss ratios are then developed, which are derived from the analysis of historical observed loss ratios, adjusted for a range of factors such as loss development, claims inflation, changes in premium rates, changes in portfolio mix and change in policy terms and conditions.

Using the development patterns and expected loss ratios described above, local reserving actuaries produce estimates of ultimate loss and allocated loss adjustment expenses.

Later the Company regularly reviews the reserving processes, including the appropriateness and consistency of assumptions.

Fair value of financial instruments

The Company determines the fair value of financial instruments that are not quoted, using valuation techniques. Those techniques are significantly affected by the assumptions used, including discount rates and estimates of future cash flows. In that regard, the derived fair value estimates cannot always be substantiated by comparison with independent markets and, in many cases, may not be capable of being realised immediately.

Valuation of investment property and land and buildings

The Company obtains valuations performed by external valuers in order to determine the fair value of its investment properties. These valuations are based upon assumptions including future rental income, anticipated maintenance costs, future development costs and the appropriate discount rate. The valuers also make reference to market evidence of transaction prices for similar properties.

The level of activity in the investment property market has been at a low level for the past few months, primarily because of the reduced availability of credit and, where credit is available, the increased cost of borrowing.

The lack of comparable market transactions has resulted in a greater level of professional judgement being relied upon in arriving at valuations. Changes in the underlying assumptions could have a significant impact on the fair values presented.

Further information in relation to the valuation of investment property is disclosed in Note 12 and in relation to the valuation of land and buildings in Note 13.

Useful lives of property and equipment

The Company reviews the estimated useful lives of property and equipment at the end of each reporting period.

Legal proceedings

In accordance with IFRS the Company recognises a provision where there is a present obligation from a past event, a transfer of economic benefits is probable and the amount of costs of the transfer can be estimated reliably. In instances where the criteria are not met, a contingent liability may be disclosed in the notes to the financial statements. Obligations arising in respect of contingent liabilities that have been disclosed, or those which are not currently recognised or disclosed in the financial statements, could have a material effect on the Company's financial position. Application of these accounting principles to legal cases requires the Company's management to make determinations about various factual and legal matters beyond its control. The Company reviews outstanding legal cases following developments in the legal proceedings and at each reporting date, in order to assess the need for provisions and disclosures in its financial statements. Among the factors considered in making decisions on provisions are the nature of litigation, claim or

assessment, the legal process and potential level of damages in the jurisdiction in which the litigation, claim or assessment has been brought, the progress of the case (including the progress after the date of the financial statements but before those statements are issued), the opinions or views of legal advisers, experience on similar cases and any decision of the Company's management as to how it will respond to the litigation, claim or assessment.

Income taxes

The Company is subject to income tax and significant judgment is required in determining the provision for income taxes. During the ordinary course of business, there are transactions and calculations for which the ultimate tax determination is uncertain. As a result, the company recognises tax liabilities based on estimates of whether additional taxes and interest will be due. These tax liabilities are recognised when, despite the company's belief that its tax return positions are supportable, the company believes that certain positions are likely to be challenged and may not be fully sustained upon review by tax authorities. The company believes that its accruals for tax liabilities are adequate for all open audit years based on its assessment of many factors including past experience and interpretations of tax law. This assessment relies on estimates and assumptions and may involve a series of complex judgments about future events. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact income tax expense in the period in which such determination is made.

6. Cash and Cash Equivalents

	2012	2011
Cash in banks	1,933,412	543,448
Cash on hand	21,445	15,935
Total cash and cash equivalents	**1,954,857**	**559,383**

7. Deposits with Banks

Deposits with banks represent the Company's main investing tool. All deposits are placed in national banks.

8. Receivables

	2012	2011
Receivables from direct insurance business	2,754,500	478,988
Receivables from reinsurance business	1,332,564	953,370
Provision for doubtful receivable	(265,734)	-
Total receivables	**3,821,330**	**1,432,358**

Concentration of receivables as at 31 December 2012 and 2011 was as follow:

		2012		2011
	Receivables	%	Receivables	%
Receivables from reinsurance business				
Ingosstrakh	552,510	41%	489,838	51%
AtaSigorta OJSC	174,896	13%	119,497	13%
Polish RE	146,718	11%	96,553	10%
Others	458,440	35%	247,482	26%
Total	**1,332,564**	**100%**	**953,370**	**100%**
Receivables from direct insurance business				
BP Exploration	2,348,165	85%	9,000	2%
US Embassy	131,153	5%	129,464	27%
Azercell	46,310	2%	62,750	13%
Ernst & Young	-	0%	59,452	12%
Others	228,872	8%	218,322	46%
Total	**2,754,500**	**100%**	**478,988**	**100%**

9. Prepayments

Prepayments represent advances made to suppliers and overpaid current income tax.

10. Reinsurance Assets

	2012	2011
Reinsurers' share in provision for unearned premiums	2,069,942	978,651
Reinsurers' share in provision for claims	171,983	130,460
Total reinsurance assets	**2,241,925**	**1,109,111**

11. Deferred Acquisition Costs

	2012	2011
Deferred acquisition costs as at 1 January	247,890	212,932
Change in deferred acquisition costs (Note 21)	224,229	34,958
Deferred acquisition costs as at 31 December	**472,119**	**247,890**

12. Property and Equipment

Movements in property and equipment for the year ended 31 December 2012 were as follows:

	Buildings	Land	Furniture & fixtures	Computers & equipment	Vehicles	Other	Total
Book value							
31 December 2011	1,956,850	9,806	145,873	77,423	127,475	12,697	2,330,124
Additions	-	-	-	11,350	51,600	-	62,950
Disposals	-	-	(2,420)	(1,908)	(103,100)	-	(107,428)
31 December 2012	**1,956,850**	**9,806**	**143,453**	**86,865**	**75,975**	**12,697**	**2,285,646**
Accumulated depreciation							
31 December 2011	181,206	-	135,375	63,824	110,069	-	**490,474**
Depreciation charge	90,603	-	5,481	7,017	6,025	-	**109,126**
Eliminated on disposal	-	-	(2,249)	(1,908)	(81,354)	-	**(85,511)**
31 December 2012	**271,809**	**-**	**138,607**	**68,933**	**34,740**	**-**	**514,089**
Net book value							
31 December 2011	**1,775,644**	**9,806**	**10,498**	**13,599**	**17,406**	**12,697**	**1,839,650**
31 December 2012	**1,685,041**	**9,806**	**4,846**	**17,932**	**41,235**	**12,697**	**1,771,557**

Movements in property and equipment for the year ended 31 December 2011 were as follows:

	Buildings	Land	Furniture & fixtures	Computers & equipment	Vehicles	Other	Total
Book value							
1 January 2011	1,956,850	9,806	151,116	69,104	115,975	12,697	**2,315,548**
Additions	-	-	-	9,975	11,500	-	**21,475**
Disposals	-	-	(5,243)	(1,656)	-	-	**(6,899)**
31 December 2011	**1,956,850**	**9,806**	**145,873**	**77,423**	**127,475**	**12,697**	**2,330,124**
Accumulated depreciation							
1 January 2011	90,603	-	111,098	57,994	102,776	-	**362,471**
Depreciation charge	90,603	-	29,520	7,486	7,293	-	**134,902**
Eliminated on disposal	-	-	(5,243)	(1,656)	-	-	**(6,899)**
31 December 2011	**181,206**	**-**	**135,375**	**63,824**	**110,069**	**-**	**490,474**
Net book value							
1 January 2011	**1,866,247**	**9,806**	**40,018**	**11,110**	**13,199**	**12,697**	**1,953,077**
31 December 2011	**1,775,644**	**9,806**	**10,498**	**13,599**	**17,406**	**12,697**	**1,839,650**

The management took the decision not to perform valuation of buildings as of 31 December 2012 because it believes that benefits of valuation do not overweight associated costs.

If the buildings were accounted at historical cost restated according to accumulated depreciation and impairment losses, its carrying value would be 864 thousand manats as at 31 December 2012 and 912 thousand manats as at 31 December 2011.

13. Investment Property

Investment property includes the building located in Baku and leased to "MediClub Dental" LLC, a related party.

If the premises were measured using the cost model, the items of the statement of financial position would be carried at 134 thousand manats as at 31 December 2012 and 141 thousand manats as at 31 December 2011.

The management took the decision not to perform valuation of investment property as of 31 December 2012 because it believes that benefits of valuation do not overweight associated costs.

14. Taxation

Income tax expense comprises the following:

	2012	2011
Current income tax charge	431,460	-
Deferred taxation movement due to origination and reversal of temporary differences	(366,572)	371,685
Total income tax charge for the year	**(64,888)**	**371,685**

The current tax rate applicable to the Company's profit is 20% (2011: 20%).

Reconciliation between the theoretical and the actual taxation charge is provided below:

	2012	2011
IFRS profit before taxation	1,431,140	1,826,166
Theoretical tax charge at the applicable statutory rate 20% (2011: 20%)	286,228	365,233
Non-deductible expenses less non-taxable income	(221,340)	6,452
Income tax charge for the year	**64,888**	**371,685**

Differences between IFRS and statutory taxation regulations of the Republic of Azerbaijan give rise to certain temporary differences between the carrying amount of certain assets and liabilities for financial reporting purposes and for the Company's profits tax purposes.

			2012			2011
	Assets	Liabilities	Net asset/ (liability)	Assets	Liabilities	Net asset/ (liability)
Accounts receivable	167,792	-	167,792		(296,484)	(296,484)
Prepayments	4,564	-	4,564	3,831	-	3,831
Property and equipment	72,437	-	72,437	79,968	-	79,968
Intangible assets	3,675	-	3,675	5,001	-	5,001
Deferred acquisition costs	-	(94,424)	(94,424)	-	(49,578)	(49,578)
Investment property	-	(71,420)	(71,420)	-	(71,420)	(71,420)
Other assets	-	(26,368)	(26,368)	-	(26,053)	(26,053)
Other liabilities	-	(45,833)	(45,833)	-	(8,716)	(8,716)
Net tax assets /	**248,468**	**(238,045)**	**10,423**	**88,800**	**(452,251)**	**(363,451)**

Movement if deferred tax balances was as follows:

	2012	2011
Deferred tax liability as at 1 January	(363,451)	932
Deferred tax credit for the year	366,572	(371,685)
Income tax relating to components of other comprehensive income	7,302	7,302
Deferred tax liability as at 31 December	**10,423**	**(363,451)**

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

15. Provision for Unearned Premiums

Below is the analysis of provision for unearned premium for the year ended 31 December 2012:

			2012
	Gross	Reinsurers' part	Net
Provision for unearned premiums as at 1 January	3,186,619	(978,651)	2,207,968
Change in provision for unearned premiums	5,099,004	(1,091,291)	4,007,713
Provision for unearned premiums as at 31 December	**8,285,623**	**(2,069,942)**	**6,215,681**

Below is the analysis of provision for unearned premium for the year ended 31 December 2011:

			2011
	Gross	**Reinsurers' part**	**Net**
Provision for unearned premiums as at 1 January	2,755,356	(682,042)	2,073,314
Change in provision for unearned premiums	431,263	(296,609)	134,654
Provision for unearned premiums as at 31 December	**3,186,619**	**(978,651)**	**2,207,968**

16. Provision for Claims

Below is the analysis of provision for claims for the year ended 31 December 2012:

			2012
	Gross	**Reinsurers' part**	**Net**
Provision for claims as at 1 January	739,018	(130,460)	608,558
Change in provision for claims	(21,001)	(41,522)	(62,523)
Provision for claims as at 31 December	**718,017**	**(171,982)**	**546,035**

Below is the analysis of provision for claims for the year ended 31 December 2011:

			2011
	Gross	**Reinsurers' part**	**Net**
Provision for claims as at 1 January	1,540,960	(94,142)	1,446,818
Change in provision for claims	(801,942)	(36,318)	(838,260)
Provision for claims as at 31 December	**739,018**	**(130,460)**	**608,558**

Below is the categorisation of provision for claims as at 31 December 2012 and 2011:

	2012	**2011**
Reported but not paid claims	339,697	377,841
Incurred but not reported claims	378,320	361,177
Provision for claims as at 31 December	**718,017**	**739,018**

17. Payables

	2012	**2011**
Claims payable	22,739	35,632
Payable to suppliers	309,109	31,192
Ceded reinsurance premiums payable	1,851,890	1,029,233
Payables to agents	252,346	120,462
Total payables	**2,436,084**	**1,216,519**

18. Deferred Commission Income

	2012	**2011**
Deferred commission income at 1 January	273,051	186,021
Change in deferred acquisition costs (Note 21)	204,760	87,030
Deferred commission income as at 31 December	**477,811**	**273,051**

19. Share Capital and Earnings Per Share

The authorised, issued and fully paid share capital of the Company comprised of:

	2012	2011
Number of shares	7,750	7,750
Par value	609	375
Share capital	**4,719,750**	**2,906,250**

Earnings per share (basic and diluted) for 2012 and 2011 were calculated as follows:

	2012	2011
Net profit for the year	1,366,252	1,454,481
Weighted average number of ordinary shares per share	7,750	7,750
Earnings per share	**176.29**	**187.67**

The Company capitalised retained earnings amounting to AZN 1,813,500 during the year ended 31 December 2012 (2011: AZN 255,750).

20. Premiums and Claims Analysis

Below is the analysis of premiums and claims by line of the Company's business for the year ended 31 December 2012:

	Insurance from fire	Vehicle insurance	Liability insurance	Travel insurance	Medical insurance	Construction insurance	Other insurance	Total
PREMIUMS								
Gross premiums written	224,119	2,202,457	61,877	42,093	11,440,224	8,914	114,960	14,094,644
Premiums ceded	(175,726)	(1,752,722)	(271,374)	(18,118)	-	(8,666)	(62,820)	(2,289,426)
Premiums written, net of reinsurance	**48,393**	**449,735**	**(209,497)**	**23,975**	**11,440,224**	**248**	**52,140**	**11,805,218**
Change in provision for unearned premiums, net	7,505	(114,497)	2,114	-	(3,905,108)	-	2,273	(4,007,713)
Earned premiums, net of reinsurance	**55,898**	**335,238**	**(207,383)**	**23,975**	**7,535,116**	**248**	**54,413**	**7,797,505**
CLAIMS								
Claims paid	808	501,779	3,146	9,650	5,521,897	-	179,471	6,216,751
Claims ceded	(1,445)	(371,508)	-	(4,556)	-	-	(143,264)	(520,773)
Net payments	**(637)**	**130,271**	**3,146**	**5,094**	**5,521,897**	**-**	**36,207**	**5,695,978**
Change in provision for claims, net	2,363	25,407	95	-	(90,770)	-	382	(62,523)
Net claims paid	**1,726**	**155,678**	**3,241**	**5,094**	**5,431,127**	**-**	**36,589**	**5,633,455**

Below is the analysis of premiums and claims by line of the Company's business for the year ended 31 December 2011:

	Insurance from fire	Vehicle insurance	Liability insurance	Travel insurance	Medical insurance	Construction insurance	Other insurance	Total
PREMIUMS								
Gross premiums written	236,367	954,959	89,969	40,547	6,678,545	38,356	100,474	8,139,217
Premiums ceded	(192,709)	(755,537)	(75,124)	(17,775)	-	(37,782)	(53,216)	(1,132,143)
Premiums written, net of reinsurance	**43,658**	**199,422**	**14,845**	**22,772**	**6,678,545**	**574**	**47,258**	**7,007,074**
Change in provision for unearned premiums, net	(18,201)	27,789	(47,946)	1,156	(153,487)	60,488	(4,453)	(134,654)
Earned premiums, net of reinsurance	**25,457**	**227,211**	**(33,101)**	**23,928**	**6,525,058**	**61,062**	**42,805**	**6,872,420**
CLAIMS								
Claims paid	10,332	352,035	8,195	6,277	5,013,730	-	42,923	5,433,492
Claims ceded	(1,344)	(242,238)	-	(2,878)	-	-	(21,000)	(267,460)
Net payments	**8,988**	**109,797**	**8,195**	**3,399**	**5,013,730**	**-**	**21,923**	**5,166,032**
Change in provision for claims, net	(3,643)	(80,757)	20,581	(35,695)	(833,842)	15,230	79,866	(838,260)
Net claims paid	**5,345**	**29,040**	**28,776**	**(32,296)**	**4,179,888**	**15,230**	**101,789**	**4,327,772**

Concentration of gross premiums written by customers was as follows:

Customer		**2012**		**2011**
	Gross premiums written	**Percentage of total**	**Gross premiums written**	**Percentage of total**
BP Exploration Caspian Sea Limited	11,396,307	80.86%	3,451,081	42.40%
Azercell	1,975,178	14.01%	1,090,203	13.40%
US Embassy	343,621	2.44%	547,610	6.73%
Fircroft Engineering	174,459	1.24%	233,760	2.87%
Others	205,079	1.45%	2,816,563	34.60%
Total	**14,094,644**	**100%**	**8,139,217**	**100%**

21. Net Acquisition Costs

	2012	2011
Fee and commission expense	757,204	548,465
Change in deferred acquisition costs	(224,229)	(34,958)
Fee and commission income	(612,483)	(313,553)
Change in deferred commission income	204,760	87,030
Net acquisition costs	**125,252**	**286,984**

22. Operating Expenses

Operating expenses related to insurance activities comprised of:

	2012	2011
Salary and bonuses	629,581	577,368
Administrative expenses	90,174	70,452
Depreciation charge	72,616	98,390
Insurance expenses	53,253	29,526
Professional services	41,905	42,428
Advertising expenses	33,699	46,494
Bank commissions	22,869	17,960
Taxes other than income tax	21,757	22,592
Vehicle expenses	20,286	17,572
Communication expenses	12,952	15,339
Business trips	10,579	4,371
Utilities	8,481	10,732
Repair and maintenance	314	1,017
Other operating expenses	36,429	30,752
Total operating expenses	**1,054,895**	**984,993**

23. Interest Income

Interest income represents revenue earned from placing idle cash balances in bank deposits (Note 7) with interest rates from 5 to 12.5% per annum (average 9%).

24. Other Income/(Loss)

	2012	2011
Rent income	32,400	32,400
Net (loss)/gain on foreign exchange operations	23,093	(9,626)
(Loss)/gain on disposal of property and equipment	(10,123)	-
Other	25,888	19,795
Total other income	**71,258**	**42,569**

25. Risk Management

The risk management function within the Company is carried out in respect of financial risks (credit, market, currency, liquidity and interest rate), operational and legal risks. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The assessment of exposure to risks also serves as a basis for optimal distribution of risk-adjusted capital, transaction pricing and business performance assessment. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimise operational and legal risks.

Industry risk. Industry risk is a possibility of incurring losses that may worsen the Company's financial condition due to concentration of operations in specific economic sector. Industry risk is managed by evaluating development of respective industry sectors (consideration of project implementation cycle, market analysis and substantiation of competitiveness, payback period and profitability), evaluating lenders, monitoring projects and determining financing forms.

Credit risk. The Company takes on exposure to credit risk which is the risk that a counterparty will be unable to pay amounts in full when due. The Company controls the credit risk it undertakes by placing limits on the amount of risk accepted in relation to one debtor, or a group of related debtors. Such risks are monitored by the Company on a regular basis, the limits being subject to an annual or more frequent review. Limits on the level of credit risk by product, debtors or groups of debtors are approved by the Company's management.

Exposure to credit risk is managed through regular analysis of the ability of clients and potential clients to meet repayment obligations and by changing these payment terms where appropriate.

The Company's maximum exposure to credit risk is primarily reflected in the carrying value of financial assets in the statement of financial position. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant. For commitments, the maximum exposure to credit risk is equal to total liabilities.

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

Market risk. The Company takes on exposure to market risks. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The management sets acceptable risk limits and monitors them on a regular basis. However, the use of this approach does not prevent losses beyond these limits in the event of more significant market movements.

The objective of market risk management is to keep the exposure to market risk within the acceptable limits assuring optimal yields for accepted risk. The market risk is assessed by the Company.

Currency risk. The Company takes on exposure to effects of fluctuations in the foreign currency exchange rates on its financial position and cash flows. The management sets limits on the level of exposure by currency and in total positions, which are monitored regularly.

The table below summarises the Company's exposure to foreign currency exchange rate risk as at 31 December 2012.

	AZN	**USD**	**EUR**	**Total**
Assets				
Cash and cash equivalents	1,907,052	47,686	119	1,954,857
Deposits with banks	7,085,439	1,552,788		8,638,227
Receivables	3,820,351	979	-	3,821,330
Prepayments	255,147	-	-	255,147
Reinsurance assets	2,241,925	-	-	2,241,925
Deferred acquisition costs	472,119	-	-	472,119
Property and equipment	1,771,557	-	-	1,771,557
Investment property	357,100	-	-	357,100
Deferred tax	10,423	-	-	10,423
Other assets	173,346	-	-	173,346
Total assets	**18,094,459**	**1,601,453**	**119**	**19,696,031**
Liabilities				
Provision for unearned premiums	8,285,623	-	-	8,285,623
Provision for claims	718,017	-	-	718,017
Payables	2,427,913	8,171	-	2,436,084
Deferred commission income	477,811	-	-	477,811
Taxes payable	83,158	-	-	83,158
Other liabilities	13,585	-	-	13,585
Total liabilities	**12,006,107**	**8,171**	**-**	**12,014,278**
Net balance sheet position	**6,088,352**	**1,593,282**	**119**	**7,681,753**

As at 31 December 2011 the Company had the following positions in currencies:

	AZN	USD	EUR	Total
Assets				
Cash and cash equivalents	501,726	55,897	1,760	559,383
Deposits with banks	4,250,000	1,245,816	486,203	5,982,019
Receivables	1,294,970	137,388	-	1,432,358
Prepayments	488,143	-	-	488,143
Reinsurance assets	1,109,111	-	-	1,109,111
Deferred acquisition costs	247,890	-	-	247,890
Property and equipment	1,839,650	-	-	1,839,650
Investment property	357,100	-	-	357,100
Other assets	182,808	-	-	182,808
Total assets	**10,271,398**	**1,439,101**	**487,963**	**12,198,462**
Liabilities				
Provision for unearned premiums	3,186,619	-	-	3,186,619
Provision for claims	739,018	-	-	739,018
Payables	1,179,231	36,945	343	1,216,519
Deferred commission income	273,051	-	-	273,051
Taxes payable	46,075	-	-	46,075
Deferred tax liabilities	363,451	-	-	363,451
Other liabilities	29,020	-	-	29,020
Total liabilities	**5,816,465**	**36,945**	**343**	**5,853,753**
Net balance sheet position	**4,454,933**	**1,402,156**	**487,620**	**6,344,709**

The Company issued insurance and reinsurance policies and bears expenses in currencies other than its functional currency. Depending on the revenue or expense stream, the appreciation or depreciation of currencies against the Azerbaijani manat may adversely affect the Company's repayment ability and therefore increases the risk of future losses.

The table below shows the change in the financial result and comprehensive income due to possible fluctuations of exchange rates used as at the reporting date if all other conditions remain unchanged. Reasonably expected exchange rate changes for each currency were projected on the basis of maximal exchange rate fluctuations in December 2012 and 2011.

		2012		**2011**
	Effect on profit or loss before taxation	**Effect on comprehensive income**	**Effect on profit or loss before taxation**	**Effect on comprehensive income**
USD appreciation by 2%	31,866	25,493	28,043	28,043
USD depreciation by 2%	(31,866)	(25,493)	(28,043)	(28,043)
EUR appreciation by 2%	2	2	9,752	9,752
EUR depreciation by 2%	(2)	(2)	(9,752)	(9,752)

The risk was calculated only for balances in currencies other than the Company's functional currency.

Liquidity risk. Liquidity risk is defined as the risk when the maturity of assets and liabilities does not match. The Company is exposed to this risk via insurance and reinsurance claims, payables to suppliers and government authorities. The Company does not accumulate cash resources to meet calls on all liabilities mentioned above, as based on the existing practice, it is possible to forecast with a sufficient degree of certainty the required level of cash funds necessary to meet the above obligations. Liquidity risk is overseen by the management with regard for decisions of the Company's Board for decision making in asset formation and transaction funding requirements.

The Company is keen on maintaining stable financing predominantly consisting of claims for insurance benefits and also on investing funds in diversified liquid asset portfolios to be able to meet unexpected liquidity needs quickly and unhampered.

To manage its liquidity, the Company is required to analyse the level of liquid assets needed to settle the liabilities on their maturity by providing access to various sources of financing, drawing up plans to solve

the problems with financing and exercising control over compliance of the liquidity ratios with the laws and regulations.

The management receives information about their financial assets and liabilities and promptly manages the Company's resources with regard for the asset and liabilities management decisions, ensures solvency and liquidity of the Company by optimising cash flows and payment calendar for efficient use of cash funds. The management regularly monitors the liquidity position.

In those cases when the amount to be paid is not fixed, the amount in the table is determined on the basis of conditions prevailing at the reporting date. Foreign currency payments are translated using the spot exchange rates effective at the reporting date.

The table below shows the maturity analysis of financial liabilities as at 31 December 2012:

	On demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 1 to 5 years	Total
Provision for unearned premiums	86,203	328,230	5,851,032	2,020,158	8,285,623
Provision for claims	25,477	692,540	-	-	718,017
Payables	805,200	1,630,884	-	-	2,436,084
Deferred commission income	155	9,358	64,627	403,671	477,811
Taxes payable	16,893	66,265	-	-	83,158
Other liabilities	13,585	-	-	-	13,585
Total liabilities	**947,513**	**2,727,277**	**5,915,659**	**2,423,829**	**12,014,278**

The table below shows the maturity analysis of financial liabilities as at 31 December 2011:

	On demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 1 to 5 years	Total
Provision for unearned premiums	322,380	320,235	1,558,738	985,266	3,186,619
Provision for claims	25,453	713,565	-	-	739,018
Payables	82,559	1,133,960	-	-	1,216,519
Deferred commission income	27,624	27,440	133,563	84,424	273,051
Taxes payable	-	46,075	-	-	46,075
Deferred tax	-	-	-	363,451	363,451
Other liabilities	-	29,020	-	-	29,020
Total liabilities	**458,016**	**2,270,295**	**1,692,301**	**1,433,141**	**5,853,753**

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

Interest rate risk. This risk appears when the Company takes on exposure to the effects of fluctuations in market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise.

The Company is not exposed to interest rate risk, principally because it has no material interest bearing liabilities. The only interest bearing asset of the Company is deposits with banks, which carry annual interest rate ranging from 9% to 12% (Note 23).

Underwriting risk. The Company assumes underwriting risk when the amount of premiums and/or the term over which they are paid by the insureds differ significantly from the amount of losses and/or the term over which they are compensated to the insureds.

The Company controls underwriting risks through:

- Underwriting departments and application of the established underwriting procedures to monitor the insurance portfolio rates by class of business;
- Outward reinsurance to mitigate the Company's exposure to great losses/catastrophes;

- Asset and liability management control to match the expected insurance premiums with the assets' maturities;
- Diversification of insurance services;
- Comprehensive actuarial analysis.

26. Capital Management

The Company's capital management has the following objectives:

- to observe requirements established by Law of the Republic of Azerbaijan "On insurance";
- to observe the minimum share capital requirements established by legislation of the Republic of Azerbaijan;
- to ensure the Company's ability to operate as a going concern;
- to maintain the scope and structure of assets used as cover for equity in accordance with respective legislation of the Republic of Azerbaijan.

The control over compliance of the asset scope and structure with the requirements of the Azerbaijani legislation is exercised on the basis of quarterly reports with the corresponding calculations that are verified and approved by the Company's Chairman of the Board and Chief Accountant. Other capital management objectives are assessed annually.

27. Contingent Liabilities

Legal issues. In the ordinary course of business, the Company is subject to legal actions and complaints. Management believes that the ultimate liability arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Company and accordingly no provision has been made as in the management's opinion the possibility of material losses is low.

Tax legislation. As disclosed in Note 14 above Azerbaijani tax legislation is subject to varying interpretations and changes which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Company may be challenged by the relevant regional or federal authorities. Recent events in Azerbaijan have shown that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the tax authorities in respect of taxes for three calendar years preceding the year of the review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2012, the management believes that its interpretation of the relevant legislation is appropriate and the Company's tax, currency and customs positions will be sustained by controlling bodies.

Operating lease commitments. The Company did not enter any non-cancellable lease arrangements.

28. Fair Value of Financial Instruments

The fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties on arm's length conditions, other than in a forced or liquidation sale. Quoted financial instruments in active markets provide the best evidence of fair value. As no readily available market exists for major part of the Company's financial instruments, the fair value shall be estimated based on current economic conditions and the specific risks attributable to the instrument. The estimates presented herein are not necessarily indicative of the amounts the Company could realise in a market exchange from the sale of its full holdings of a particular instrument.

Management believes that carrying values of the Company's financial assets and liabilities approximate their fair values.

The Company uses the following methods and assumptions to estimate the fair value of the following financial instruments:

Accounts receivable. Accounts receivable are recorded net of impairment provision. Provision for impairment is estimated on the basis of risk analysis covering such factors as current economic situation in the debtor's industry, the financial position of a debtor and the guarantees received. Long-term accounts receivable are carried at amortised cost using the discount rate approximating current market rates.

Accounts payable. Short-term payables are stated at the nominal amount due. Long-term payables are measured at amortised cost using the discount rate that is equal to market interest rate on loans used for similar debt financing. The fair value of cash and other financial assets and liabilities approximates their carrying amount due to their short-term nature.

29. Reconciliation of Categories of Financial Instruments with Measurement Categories

In accordance with IAS 39 “Financial Instruments: Recognition and Measurement” the Company classifies its financial assets in the following categories: 1) financial assets at fair value through profit or loss; 2) loans and receivables; 3) financial assets available for sale.

At the same time, in accordance with IFRS 7 “Financial Instruments: Disclosures” the Company discloses different classes of financial instruments. As at 31 December 2012 and 2011 all financial assets of the Company were classified as loans and receivables.

All financial liabilities of the Company are classified as measured at amortised cost.

30. Related Party Transactions

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 “Related Party Disclosures”. In considering each possible related party relationship, attention is directed to the economic substance of the relationship, not merely the legal form.

In the normal course of business the Company enters into transactions with its major shareholders, directors, subsidiaries and other related parties. These transactions include settlements, issuance of loans, deposit taking, guarantees, trade finance and foreign currency transactions.

The outstanding balances at the year end and asset transactions with related parties as of 31 December 2012 and 2011 were as follows:

	2012		2011	
	Related party transactions	Total category	Related party transactions	Total category
Prepayments		-		488,143
- companies controlled by the shareholder		-	3,030	
Other liabilities		2,899,097		-
- companies controlled by the shareholder	29,407		-	
Claims paid		(6,216,751)		(5,433,492)
- companies controlled by the shareholder	(2,532,787)		(2,728,492)	
Operating expenses		(1,054,895)		(984,993)
- key management personnel	(141,744)		(110,546)	
Other income/(loss)		63,956		42,569
- companies controlled by the shareholder	32,400		32,400	

31. Subsequent Events

On 28 February 2013 capital of the Company was increased to AZN 5,400,200 (7,750 shares AZN 696.80 each) by capitalising retained earnings.

On 28 June 2013 the Company disposed its headquarter building (carrying value of AZN 858,018 as at 31 December 2012) for AZN 1,450,000.