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Minister _____ Togrul Musayev	Governor of the Management Board _____ E.Rustamov

Agreed with
Chamber of Auditors of Azerbaijan Republic
February 12, 2007
Chairman, Chamber of Auditors

_____ Vahid Novruzov

**REGULATIONS ON REQUIREMENTS ON
EXTERNAL AUDITING
OF
BANKS AND LOCAL BRANCHES OF FOREIGN BANKS**

(as amended on July 10, 2009 and April 15, 2010)

1. General provisions

- 1.1. These Regulations have been developed in accordance with the Laws of Azerbaijan Republic «On the Central Bank of Azerbaijan Republic», «On banks», and «On audit service», recommendations of the Basel Committee for Banking Supervision, as well as other accepted auditing regulations, and identifies the requirements with respect to external audits of banks and local branch offices of foreign banks (hereinafter referred to as banks).
- 1.2. These Regulations shall not apply to external audits carried out by the Central Bank of Azerbaijan Republic (hereinafter referred to as the Central Bank) and by banks at their own discretion.
- 1.3. External auditing standards required hereunder shall also apply to audits of subsidiaries of banks consolidating their financial statements in accordance with the International Financial Reporting Standards (hereinafter referred to as IFRS).

1. Definitions

2.1. Terms used herein shall have the following meanings:

2.1.1. Auditor — an audit firm or an independent auditor who has a special permit (license) issued in accordance with the applicable laws of Azerbaijan Republic. For the purposes hereof, «external auditor» and «auditor» shall have the same meaning. To differentiate between external auditors and internal auditors, the term «internal auditor» shall be used in relevant sections hereof.

2.1.2. Unqualified positive opinion — an auditor's opinion confirming that the bank's IFRS-compliant financial statements provide an objective and fair presentation of the bank's financial position and performance (or all significant issues).

2.1.3. Qualified positive opinion — an auditor's opinion issued when an unqualified positive opinion is not possible, but limitations or disagreement with the bank's administrators are not sufficiently significant or credible to waive an opinion or to give a negative opinion.

2.1.4. Negative opinion — an auditor's opinion issued when it is impossible to give a qualified positive opinion to indicate that the bank's financial statements are erroneous or incomplete because disagreement with the bank's management is significant and credible.

2.1.5. Waiver of opinion — an auditor's opinion issued when the auditor is unable to give an opinion on the bank's financial statements due to lack of evidence because of excessively significant and credible limitations in the auditor's work.

2.1.6. Letter of commitment — a written document that identifies the terms and conditions, as well as the purpose and scope of the audit, the auditor's obligations to the bank and the bank's obligations to the auditor.

2.1.7. International Standards on Auditing (hereinafter referred to as ISA) — standards used for examining financial information covering past periods, issued by the International Auditing and Assurance Standards Board, a committee of the International Federation of Accountants (hereinafter referred to as IFA). For the purposes hereof, the following documents published by the IFA shall be hereinafter collectively referred to as ISA

- Code of Conduct for professional accountants;
- International Principles for Assurance Activities;
- International Quality Control Standards;
- International Auditing Standards;
- International Auditing Statements.

2.1.8. Independent opinion — an individual's ability to give an opinion free of factors that may affect professional judgement, and to be correct, objective and to act

with caution.

- 2.1.9. Independent vision — lack of significant facts and conditions that may cause an informed third party to decide against the auditor's trustworthiness in terms of correctness, objectivity and professionalism.
- 2.1.10. Management report (Management letter) — a written document presented by the auditor to the bank upon completion of audit.

2.2. Constraints on the auditor's work may be imposed by the bank, or, in some cases, by circumstances (e.g., the agreement prevents the auditor from implementing procedures the auditor deems necessary, the audit agreement and assignment period do not enable the auditor to check the inventories, etc.). Constraints may arise also when the auditor believes the bank's accounting records to be inadequate, or the auditor is unable to perform audit procedures the auditor believes appropriate.

2.3. Disagreements with the bank's administrators may arise when an agreement cannot be reached on the auditor-selected accounting policy, its implementation methods or adequacy of financial disclosures.

2.4. Other terms and definitions used herein shall have the meanings ascribed to them in the Laws «On banks», «On accounting» «On audit service» and other existing laws of Azerbaijan Republic.

1. Auditing Standards

3.1. These Regulations require audits of banks' financial statements to apply the ISA.

3.2. IFRS shall be used as the criterion for financial reporting standards to evaluate financial statements of banks.

3.3. When the laws of Azerbaijan Republic define auditing requirements for banks other than the ISA, such requirements shall be fulfilled in addition to the ISA requirements.

If there are any conflicts between the requirements defined in the laws of Azerbaijan Republic and the ISA requirements, the laws of Azerbaijan Republic shall prevail.

4. Independence of external auditor

4.1. The external auditor must conduct his audit independently of the banks, their administrators and shareholders, including major/significant shareholders.

4.2. The auditor's independence is predicated on his independent opinion and independent vision.

4.3. The auditor shall be deemed to have lost his independence if any of the following has a significant impact on his actions and cannot be reduced to an acceptable level:

4.3.1. The risk of «pursuit of personal interests» arises when the auditor may benefit from financial interests vested in the audited bank or a conflict with such bank's interests;

4.3.2. The risk of «self-check» arises when previous findings and judgements need to be re-assessed to obtain audit findings or when the auditor used to be an administrator of the audited bank or an employee who could exercise a direct and significant influence on the subject of the audit;

4.3.3. The risk of «promotion» arises as a result of promotional activities of the auditor who exposes the objectivity of the audited bank or the opinion on such bank to hazard;

4.3.4. The risk of «relation» arises when close relationships with the audited bank, its administrators or employees may lead to a conflict of interests;

4.3.5. The risk of «threats» arises when the auditor may lose objectivity because the audited bank's administrators or employees threaten or are likely to threaten the auditor.

5. Selection and replacement of external auditor

5.1. Banks shall be free in selecting external auditors. The bank's Audit Committee shall receive the following information from the prospective auditor:

- 5.1.1. existence of the special permit (license) for auditing;
- 5.1.2. the auditor's track record;
- 5.1.3. names, education and professional background of other auditors and experts (if applicable) to be involved in the bank's audit;
- 5.1.4. a statement of the auditor to confirm the auditor's independence and provide a detailed description of any relationship of the auditor, his employees or an entity under joint control and joint ownership with the bank, the bank's administrators, the bank's related parties and persons acting on behalf of the bank's related parties in the past three years or anticipated in the future;
- 5.1.5. any other business information for selection of an auditor that the Audit Committee may deem important.

5.2. The selected auditor shall be knowledgeable in IFRS, and shall have experience of auditing banks and other financial institutions.

5.3. An audit agreement shall be signed with the external auditor and a notice to this effect shall be presented to the Central Bank by the 15th of the month of November of the year to be covered by the audit.

5.4. In addition to the audit agreement signed between the bank and the auditor, the auditor shall send an ISA-compliant «Letter of Commitment» to the bank and the bank shall confirm receipt of the letter.

5.5. In event of an early termination of an external audit, the bank shall notify the Central Bank within 5 (five) business day from the date of such termination. The notice shall specify the reasons of termination of the contract.

5.6. If a bank is audited by the same external auditor for at least 5 consecutive years, the Central Bank may require the bank to appoint another auditor (rotation) in order to ensure objectivity and impartiality of audits.

6. Rights and responsibilities of external auditor

6.1. The external auditor of a bank shall have the following rights:

- 6.1.1. to determine the audit plan and audit procedures independently;
- 6.1.2. to access, or to receive from the bank or third parties, all documents necessary for the audit of performance of the bank and its subsidiaries, including audit findings from previous years;
- 6.1.3. to verify existence of cash, securities, tangible and intangible assets of the bank and its subsidiaries;
- 6.1.4. to get explanations from bank administrators and employees in order to evaluate the risks associated with material errors that may take place in financial statements, and judgements used in developing the assumptions used in accounting and applied in the implementation of the accounting policy;
- 6.1.5. to use the findings of the bank's internal auditor after having identified the relevant internal audit requirements of the ISA;
- 6.1.6. to refuse to audit the bank if the bank fails to provide the necessary documentation;
- 6.1.7. to require appropriate conditions of work necessary to conduct the audit;
- 6.1.8. to recommend corrections to the bank's administrators in order to remove the deficiencies identified;
- 6.1.9. to engage experts in the audit, with the bank's consent (individuals or legal entities that possess special knowledge, experience and skills in areas other than accounting and auditing);
- 6.1.10. to exercise other statutory rights.

6.2. The external auditor shall have the following responsibilities:

- 6.2.1. to audit the bank in accordance with the ISA and provisions hereof;
- 6.2.2. to evaluate the bank's compliance with the corporate governance standards established by the Central Bank;
- 6.2.2-1. to evaluate the bank's loan portfolio and loss provisioning, non-performing loans, asset re-financing, as well as the bank's securities and off-balance sheet transactions;
- 6.2.2-2. to ascertain the adequacy of the bank's risk measurement and management, fair value of assets identification methodologies, as well as internal controls of financial reporting;
- 6.2.3. to prepare and present to the bank the Audit Report, Management Report and other reports and information as required hereunder, within the timeframes specified in the agreement signed between the bank and the auditor;
- 6.2.4. to report to the Central Bank any serious violations, losses or illegal activities that may have a negative impact on the bank's ability to fulfil its liabilities exposing the bank's depositors and creditors to serious risks, as well as the bank's liquidity position or may reduce the bank's total capital to a point below the statutory minimum;
- 6.2.5. to fulfill any other obligations stipulated in the applicable laws and the agreement signed between the bank and the external auditor.

7. Audit report

7.1. The audit report shall be prepared on the basis of audit findings in accordance with the applicable laws.

7.2. Each audit report prepared by the auditor in accordance with the provisions hereof shall contain the following main elements:

- 7.2.1. title of the report;
- 7.2.2. person the report is addressed to;
- 7.2.3. introductory section specifying the financial statements audited and the responsibility of the entity's management and the auditor;
- 7.2.4. a section containing references to the ISA statements and a description of the work performed by the auditor (a section describing the type of audit);
- 7.2.5. a section asserting that the financial reporting structure used for developing financial statements is in compliance with the IFRS and containing the auditor's opinion on the financial statements.

When forming an opinion, the auditor shall collect sufficient audit evidence allowing for making conclusions to write this opinion. The auditor's opinion shall increase the credibility of the financial statements by creating a certain degree of assurance. The audit cannot provide absolute assurance. This is due to the fact that judgements, tests, accounting and internal control limitations, as well as the fact that the evidence collected by the auditor are not final and conclusive, but satisfactory (substantive).

The auditor's opinion may be «unqualified positive», «qualified positive», «negative» or «waiver of opinion».

- 7.2.6. date of the report;
- 7.2.7. the auditor's address;
- 7.2.8. the auditor's signature;
- 7.2.9. complete financial statements consisting of the following components:
 - balance sheet statement, income statement, statement of changes in equity, cash flow statement, accounting policy and notes.

7.3. The audit report may also include sections on issues that are significant for stressing

factors affecting financial statements. A more detailed description of such issues shall be presented in the notes to the financial statements. Inclusion of such sections shall not affect the auditor's opinion. The auditor may also add other sections to the audit report that describe other significant issues that do not affect the financial statements.

- 7.4. The auditor may present a «Management Report» to the bank upon completion of the audit. This letter describes issues that are not required to be disclosed in the annual financial statements, but that were noted in course of the audit and drew the auditor's attention, and the associated proposals. The letter shall be presented to the bank's Management Board, Audit Committee and Supervisory Board. The Management Report may contain the following details: main risks, unusual facts, improvement proposals for internal controls, views on improvement of processes and structures, alternative solutions for more effective uses of funds. The general format of the Management Report may also cover changes to proposals made in the last year, findings of the current year, associated risks, proposals and persons responsible for taking measures.
- 7.5. Before publishing any additional disclosures that are supposed to accompany the audited financial statements, banks shall present them to the auditor to identify whether there are any significant discrepancies between the financial statements and such additional disclosures. If the bank refuses to amend the additional disclosures as recommended by the auditor, an auditor's note shall be published together with such additional disclosures stating the issue an agreement was not reached upon.

8. Responsibility of banks to present audit reports and other information to the Central Bank

- 8.1. Banks shall present copies of financial statements together with copies of the Audit Report and Management Report to the Central Bank within the first 5 (five) months of the year following the relevant reported year, but no later than 3 (three) business days from the date the Audit Report is signed.
- 8.2. If the audit covers a different period, banks shall present a copy of the audit report within 3 (three) business days from the date the report was signed.
- 8.3. Banks shall address all deficiencies identified by the external auditor in their financial statements and shall prepare and present to the Central Bank a list of all audit adjustments together with appropriate explanations within the first 6 (six) months of the year following the reported year.
- 8.4. Banks shall provide a written reply to the auditor on the deficiencies and flaws specified in the Management Report within 1 (one) month from the date of receipt thereof, and shall present a copy of such reply to the Central Bank.
- 8.5. The audit report presented to the Central Bank shall be in Azerbaijani. The report shall be bound, with its pages numbered, and sealed, with the total number of pages noted on the backside of the last page.

1. Final provision

These Regulations shall take effect as of the date of state registration.