

INVEST KREDIT Non-Banking Credit Organization

**International Financial Reporting Standards
Financial Statements and
Independent Auditor's Report**

31 December 2009

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors of Invest Kredit Non-Banking Credit Organization:

We have audited the accompanying financial statements of Invest Kredit NBCO which comprise the balance sheet as of 31 December 2009 and the income statement, statement of changes in equity and statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 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.

Opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Organization as of 31 December 2009, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Kernur Audit LLC
Baku, Azerbaijan Republic
5 April 2010

INVEST KREDIT Non-Banking Credit Organization
Balance Sheet

<i>In Azerbaijani mantas</i>	Note	31 December 2009	31 December 2008
ASSETS			
Cash and cash equivalents	7	9,807	22,957
Trading securities			
Other financial assets at fair value through profit or loss			
Due from other banks			
Loans and advances to customers, net	8	410,889	94,518
Investment securities available for sale			
Repurchase receivable			
Investment securities held to maturity			
Investment properties			
Investment in associates			
Current income tax prepayment			
Deferred income tax asset			
Goodwill			
Intangible assets			
Premises and equipment, net	9	7,471	2,983
Other financial assets			
Other assets	10	5,906	290
Non-current assets held for sale (or disposal Organizations)			
TOTAL ASSETS		434,073	120,748
LIABILITIES			
Due to other banks			
Customer accounts			
Debt securities in issue [Promissory notes issued]			
Other borrowed funds	11	350,248	96,000
Current income tax liability			
Deferred income tax liability			
Provisions for liabilities and charges		(327)	
Other financial liabilities			
Other liabilities	12	4,183	676
Subordinated debt			
Liabilities directly associated with non-current assets held for sale (or disposal Organizations)			
TOTAL LIABILITIES		354,104	96,676
EQUITY			
Share capital		70,000	16,000
Retained earnings [Accumulated deficit]		(1,009)	1,594
Other reserves	13	10,978	6,478
Net assets attributable to the Bank's equity holders			
Minority interest			
TOTAL EQUITY		79,969	24,072
TOTAL LIABILITIES AND EQUITY		434,073	120,748

Approved for issue and signed on behalf of the Board of Directors on 5 April 2010

Mr. Elgiz Dadashov
Managing Director

Mr. Vusal Salimov
Chief Accountant

INVEST KREDIT Non-Banking Credit Organization
Income Statement

<i>In Azerbaijani manats</i>	Note	2009	2008
Interest income	14	63,914	9,450
Interest expense	14	21,036	(2,050)
Net interest income/(Net interest expense)		42,878	7,400
Provision for loan impairment		(5,304)	(1,915)
Net interest income/(net interest expense) after provision for loan impairment		37,574	5,485
Fee and commission income	15	14,292	2,800
Fee and commission expense		(2,445)	
Gains less losses from trading securities			
Gains less losses from financial derivatives			
Gains less losses from other financial assets at fair value through profit or loss			
Gains less losses from trading in foreign currencies			
Gains less losses on revaluation of investment properties			
Foreign exchange translation gains less losses			
Gains/(losses) on initial recognition of assets at rates above/below market			
Gains/(losses) on initial recognition of liabilities at rates below/above market			
Impairment of investment securities available for sale			
Gains less losses from disposals of investment securities available for sale			
Impairment of investment securities held to maturity			
Provision for credit related commitments			
Other operating income		3,402	
Gains/(losses) arising from early retirement of debt			
Administrative and other operating expenses	16	(51,670)	(7,899)
Share of profit of associates			
Profit/(loss) before tax		1,153	386
Income tax (expense)/credit	17		
Profit/(loss) for the year		1,153	386
Profit/(loss) is attributable to			
Equity holders		1,153	386
Minority interest			
Profit/(loss) for the year		1,153	386
Earnings [Loss] per share for profit [loss] attributable to the equity holders of the Bank, basic and diluted (expressed in AZN per share)			

INVEST KREDIT Non-Banking Credit Organization
Statement of Changes in Equity

	Note	Attributable to equity holders of the Bank			Minority interest	Total Equity
		Share Capital	Other reserves (Note Error! Reference source not found.)	Retained earnings [Accumulated deficit]		
<i>In Azerbaijani mantas</i>						
Previously reported balance at 31 December 2007		1,000	4,598	5,339	10,937	10,937
Effects of adoption of new or revised standards						
Adjusted at 1 January 2008						
Available-for-sale investments:						
- Fair value gains less losses						
- Disposals or impairment						
Premises and equipment:						
- Revaluation						
- Realised revaluation reserve						
Currency translation differences						
Income tax recorded in equity						
Net income recognised directly in equity						
Profit [Loss] for the year				(3,745)	(3,745)	(3,745)
Total recognised income for 2008				(3,745)	(3,745)	(3,745)
Share issue		15,000			15,000	15,000
Treasury shares:						
- Acquisitions						
- Disposals						
Other reserves	13		1,880		1,880	1,880
Dividends declared						
Balance at 31 December 2008		16,000	6,478	1,594	24,072	24,072
Available-for-sale investments:						
- Fair value gains less losses						
- Disposals or impairment						
Premises and equipment:						
- Revaluation						
- Realised revaluation reserve						
Currency translation differences						
Income tax recorded in equity						
Net income recognised directly in equity				(3,756)	(3,756)	(3,756)
Profit [Loss] for the year				1,153	1,153	1,153
Total recognised income for 2009				(2,603)	(2,603)	(2,603)
Share issue		54,000			54,000	54,000
Treasury shares:						
- Acquisitions						
- Disposals						
Other reserves	13		4,500		4,500	4,500
Dividends declared						
Balance at 31 December 2009		70,000	10,978	(1,009)	79,969	79,969

INVEST KREDIT Non-Banking Credit Organization
Notes to the Financial Statements – 31 December 2009

<i>In Azerbaijani mantas</i>	Note	2009
Cash flows from operating activities		
Interest received		63,914
Interest paid		(21,036)
Fees and commissions received		14,292
Fees and commissions paid		(2,445)
Income received from trading in trading securities		
Income received from financial derivatives		
Income received from trading in foreign currencies		
Other operating income received		3,402
Staff costs paid		(40,754)
Administrative and other operating expenses paid		(16,220)
Income tax paid		
Cash flows from/(used in) operating activities before changes in operating assets and liabilities		1,153
Net (increase)/decrease in trading securities		
Net (increase)/decrease in other financial assets at fair value through profit or loss		
Net (increase)/decrease in due from other banks		
Net (increase)/decrease in loans and advances to customers		
		(316,371)
Net (increase)/decrease in repurchase receivable		
Net (increase)/decrease in other financial assets		
Net (increase)/decrease in other assets		
		(5,617)
Net increase/(decrease) in due to other banks		
Net increase/(decrease) in customer accounts		
Net increase/(decrease) in debt securities in issue		
		254,248
Net increase/(decrease) in other financial liabilities		
		3,507
Net increase/(decrease) in provisions for liabilities and charges and other liabilities		
		(327)
Net cash from/(used in) operating activities		(64,559)
Cash flows from investing activities		
Proceeds from redemption of investment securities held to maturity		
Acquisition of premises and equipment		
	9	(4,488)
Proceeds from disposal of premises and equipment		
Net cash from/(used in) investing activities		(4,488)
Cash flows from financing activities		
Issue of ordinary shares		
Issue of preference shares		
Capital contributions from shareholders other than through issuance of shares		
	13, 14	55,896
Acquisition of treasury shares		
Net cash from/(used in) financing activities		55,896
Effect of exchange rate changes on cash and cash equivalents		
Net increase/(decrease) in cash and cash equivalents		(13,151)
Cash and cash equivalents at the beginning of the year		
		22,957
Cash and cash equivalents at the end of the year		9,807
	7	

1 Introduction

These financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2009 for Invest Kredit NBCO (the "Organization").

The Organization was incorporated and is domiciled in the Azerbaijan Republic.

Principal activity. The Organization's principal business activity is non-banking credit operations within the Azerbaijan Republic. The Organization has operated under a licence issued by the National Bank of Azerbaijan Republic ("CBAR") since 2005.

The Organization has no branches within the Azerbaijan Republic and overseas. Additionally, the Bank has no representative offices.

Registered address and place of business. The Bank's registered address is:
529 Matbuat ave.
Baku, AZ1073, Azerbaijan

Presentation currency. These financial statements are presented in Azerbaijani Manats ("AZN "). The Azerbaijani Manat ("AZN") is the official currency of the Azerbaijan Republic.

At 31 December 2009, the principal rate of exchange used for translating foreign currency monetary balances was USD 1 = AZN 0.8031 (2008: USD 1 = AZN 0.8010).

2 Operating Environment of the Organization

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

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

2 Operating Environment of the Organization (Continued)

Recent volatility in global financial markets. The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, at times much higher than normal interbank lending rates, and lower liquidity levels across the Azerbaijan Republic banking sector resulting in a significant reduction in the number of new loans and advances made to customers, and higher funding costs where its remains possible to obtain debt finance from International Institutions or other local banks. The uncertainties in the global financial market, has also led to bank failures and bank rescues in the United States of America, Western Europe and in Russia. Such circumstances could affect the ability of the Organization to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions. The borrowers of the Organization may also be affected by the lower liquidity situation which could in turn impact their ability to repay their outstanding loans. Deteriorating operating conditions for borrowers may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent that information is available, management has reflected revised estimates of expected future cash flows in their impairment assessments.

Management is unable to reliably estimate the effects on the Organization's financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes that they are taking all the necessary measures to support the sustainability and growth of the Organization's business in the current circumstances.

3 Summary of Significant Accounting Policies

Basis of preparation. These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the revaluation of premises. The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated (refer to Note 5).

Going concern. Management have prepared these financial statements on a going concern basis. In making this judgement management have considered the current favourable macroeconomic environment for financial institutions operating in Azerbaijan, positive cash flows, the profitability of operations and access to foreign financial resources as required. As disclosed in Note 7 to these financial statements, the Organization has a cumulative positive liquidity gap up to twelve months as at 31 December 2009 and as at 31 December 2008. Management is confident that the Organization will be able to obtain required funds in order to replace attracted liabilities with duration of up to twelve months. In particular, management believe that the continued support of its shareholders and access to borrowings from international financial institutions means that the Organization would be able to obtain appropriate resources should all liabilities require settlement as disclosed in Note 14. Management's ongoing discussions with its current lenders have reaffirmed management's view that the borrowings subjected to covenants as detailed in Notes 9 and 16 will not in practices require repayment prior to the contractual dates.

Amendments of the financial statements after issue. The Organization's shareholders and management have the power to amend the financial statements after issue.

Consolidated financial statements. As the Organization has no subsidiaries and representative office, its financial statements can be measured as a Financial Statements.

3 Summary of Significant Accounting Policies (Continued)

Financial instruments - key measurement terms. Depending on their classification financial instruments are carried at fair value, cost, or amortised cost as described below.

Fair value is the amount, for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair value is the current bid price for financial assets and current asking price for financial liabilities which are quoted in an active market. For assets and liabilities with offsetting market risks, the Organization may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange or other institution and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Valuation techniques such as discounted cash flows models or models based on recent arms length transactions or consideration of financial data of the investees are used to fair value certain financial instruments, for which external market pricing information is not available. Valuation techniques may require assumptions not supported by observable market data. Disclosures are made in these financial statements if changing any such assumptions to a reasonably possible alternative would result in significantly different profit, income, total assets or total liabilities.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes transaction costs. Measurement at cost is only applicable to investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortised cost is the amount, at which the financial instrument was recognised at initial recognition, less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related balance sheet items.

The effective interest method is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate (refer to income and expense recognition policy).

3 Summary of Significant Accounting Policies (Continued)

Cash and cash equivalents. Cash and cash equivalents are items, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. All short-term inter-bank placements, beyond overnight placements, are included in due from other banks. Amounts, which relate to funds that are of a restricted nature, are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

Mandatory cash balances held with the CBAR. The Organization has no mandatory cash balances with the CBAR due to legislation.

Due from other banks. Amounts due from other banks are recorded when the Organization advances money to counterparty banks with no intention of trading the resulting unquoted non-derivative receivable due on fixed or determinable dates. Amounts due from other banks are initially recognised at fair value plus transaction costs and subsequently carried at amortised cost.

Loans and advances to customers. Loans and advances to customers are recorded when the Organization advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates and has no intention of trading the receivable. Loans and advances to customers are initially recognised at fair value plus transaction costs and subsequently carried at amortised cost.

Impairment of financial assets carried at amortised cost. Impairment losses are recognised in profit or loss when incurred as a result of one or more events (“loss events”) that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or Organization of financial assets that can be reliably estimated. If the Organization determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a Organization of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The primary factors that the Organization considers whether a financial asset is impaired are its overdue status and realisability of related collateral, if any. The following other principal criteria are also used to determine that there is objective evidence that an impairment loss has occurred:

- any instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
- the borrower experiences a significant financial difficulty as evidenced by borrower’s financial information that the bank obtains;
- the borrower considers bankruptcy or a financial reorganisation;
- there is adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impact the borrower; or
- the value of collateral significantly decreases as a result of deteriorating market conditions.

For the purposes of a collective evaluation of impairment, financial assets are banded on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for Organizations of such assets by being indicative of the debtors’ ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a Organization of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent, to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

If the terms of a financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms.

3 Summary of Significant Accounting Policies (Continued)

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss.

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined.

Credit related commitments. The Organization enters into credit related commitments, including letters of credit and financial guarantees. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties and carry the same credit risk as loans. Financial guarantees and commitments to provide a loan are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Organization will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At each balance sheet date, the commitments are measured at the higher of (i) the remaining unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required settling the commitment at the balance sheet date.

Premises and equipment. Premises are stated at revalued amounts. Equipment is stated at cost less accumulated depreciation and impairment losses, where required.

Premises of the Organization are subject to revaluation on a regular basis. The frequency of revaluation depends upon the movements in the fair values of the premises being revalued. The revaluation reserve for premises included in equity is transferred directly to retained earnings when the surplus is realised, ie either on the retirement or disposal of the asset, or as the asset is used by the Organization; 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.

Construction in progress is carried at cost less provision for impairment where required. Cost includes borrowing costs incurred on specific or general funds borrowed to finance construction of qualifying assets. Upon completion, assets are transferred to premises and equipment at their carrying amount. Construction in progress is not depreciated until the asset is available for use.

All other items of premises and equipment are stated at cost less accumulated depreciation and impairment losses, if any.

Costs of minor repairs and maintenance are expensed when incurred. Cost of replacing major parts or components of premises and equipment items are capitalised and the replaced part is retired.

If impaired, premises and equipment are written down to the higher of their value in use and fair value less costs to sell. The decrease in carrying amount is charged to profit or loss 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 value in use or fair value less costs to sell.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss.

3 Summary of Significant Accounting Policies (Continued)

Depreciation. Land is not depreciated. Depreciation on other items of premises and equipment is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives as follows:

	2009	2008
Premises	2.5%-5%	2.5%-5%
Leasehold improvements	10%	10%
Computers and other communication equipment	25%	25%
Plastic cards operations equipment	33%	33%
Furniture, fixtures, automated teller machines and other	20%-25%	20%-25%
Motor vehicles	25%	25%

The residual value of an asset is the estimated amount that the Organization 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 residual value of an asset is nil if the Organization expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

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

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

Debt securities in issue. Debt securities in issue include promissory notes, bonds, certificates of deposit and debentures issued by the Organization. Debt securities are stated at amortised cost. If the Organization purchases its own debt securities in issue, they are removed from the balance sheet and the difference between the carrying amount of the liability and the consideration paid is included in gains arising from retirement of debt.

Other borrowed funds. Other borrowed funds are non-derivative liabilities to local non-bank and international financial institutions and are carried at amortised cost.

Income taxes. Income taxes have been provided for in the financial statements in accordance with relevant legislation enacted or substantively enacted by the balance sheet date in a country of legislation of the Organization's entity. The income tax charge comprises current tax and deferred tax and is recognised in the income statement except if it is recognised directly in equity because it relates to transactions that are also recognised, in the same or a different period, directly in equity.

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 and prior periods. Taxable profits or losses are based on estimates if financial statements are authorised prior to filing relevant tax returns. Taxes, other than on income, are recorded within administrative and other operating expenses. Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date, which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Organization. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available, against which the deductions can be utilised.

3 Summary of Significant Accounting Policies (Continued)

Deferred income tax is provided on post acquisition retained earnings of subsidiaries, except where the Organization controls the subsidiary's dividend policy and it is probable that the difference will not reverse through dividends or otherwise in the foreseeable future.

Uncertain tax positions. The Organization's uncertain tax positions are reassessed by management at every balance sheet date. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the balance sheet date and any known Court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognised based on management's best estimate of the expenditure required to settle the obligations at the balance sheet date.

Provisions for liabilities and charges. Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when the Organization has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Trade and other payables. Trade payables are accrued when the counterparty has performed its obligations under the contract and are carried at amortised cost.

Share premium. When shares are issued, the excess of contributions received, net of transaction costs, over the nominal value of the shares issued is recorded as share premium in equity.

Dividends. Dividends are recorded in equity in the period, in which they are declared. Dividends declared after the balance sheet date and before the financial statements are authorised for issue are disclosed in the subsequent events note. The statutory accounting reports of the Bank are the basis for profit distribution and other appropriations of the Bank. Azerbaijani legislation identifies the basis of distribution as the current year net profit.

Income and expense recognition. Interest income and expense are recorded in the income statement for all debt instruments on an accrual basis, using the effective interest method. This method defers, as part of interest income or expense, all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents. Commitment fees received by the Organization to originate loans at market interest rates are integral to the effective interest rate if it is probable that the Organization will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination. The Organization does not designate loan commitments as financial liabilities at fair value through profit or loss.

When loans and other debt instruments become doubtful of collection, they are written down to present value of expected cash inflows and interest income is thereafter recorded for the unwinding of the present value discount based on the asset's effective interest rate, which was used to measure the impairment loss.

All other fees, commissions, including fees and commissions on plastic cards, and other income and expense items are generally recorded on an accrual basis by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided. Loan syndication fees are recognised as income when the syndication has been completed and the Organization retained no part of the loan package for itself or retained a part at the same effective interest rate for the other participants.

3 Summary of Significant Accounting Policies (Continued)

Commissions and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, which are earned on execution of the underlying transaction are recorded on its completion. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-proportion basis. Asset management fees related to investment funds are recorded rateably over the period the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time.

Foreign currency translation. The functional currency of each of the Organization's entities is the currency of the primary economic environment, in which the entity operates. The Organization's functional currency and the Organization's presentation currency is the national currency of the Azerbaijan Republic, Azerbaijani Manat ("AZN").

Monetary assets and liabilities are translated into each entity's functional currency at the official exchange rate of the CBAR at the respective balance sheet dates. Foreign exchange gains and losses resulting from the settlement of transactions and from the translation of monetary assets and liabilities into each entity's functional currency at year-end official exchange rates of the CBAR are recognised in profit or loss. Translation at year-end rates does not apply to non-monetary items, including equity investments. Effects of exchange rate changes on the fair value of equity securities are recorded as part of the fair value gain or loss.

The results and financial position of each Organization entity (the functional currency of none of which is a currency of a hyperinflationary economy) are translated into the presentation currency as follows:

- (i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- (ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- (iii) all resulting exchange differences are recognised as a separate component of equity.

When a subsidiary is disposed of through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity, the exchange differences deferred in equity are reclassified to profit or loss.

Offsetting. Financial assets and liabilities are offset and the net amount reported in the balance sheet 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.

Staff costs and related contributions. Wages, salaries, contributions to the Azerbaijan Republic state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by the employees of the Organization.

Segment reporting. A segment is a distinguishable component of the Organization that is engaged in providing products or services (business segment), which is subject to risks and rewards that are different from those of other segments. Segments with a majority of revenue earned from services to external customers and whose revenue, result or assets are ten percent or more of all the segments are reported separately. Geographical segments of the Organization have been reported separately within these financial statements, on the basis that, a significant majority of the Organization's operations are carried out in the Azerbaijan Republic and revenues from other segments are not more than ten percent of total revenues earned by the Organization.

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies

The Organization makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Impairment losses on loans and advances. The Organization regularly reviews its loan portfolios to assess impairment. In determining whether an impairment loss should be recorded in the income statement, the Organization makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a Organization, or national or local economic conditions that correlate with defaults on assets in the Organization. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Other borrowed funds. Management has considered whether gains or losses should arise on initial recognition of loans from governmental and international financial institutions and related lending. The Bank obtains long term financing from international financial institutions at interest rates, at which such institutions ordinarily lend in emerging markets and which may be lower than rates, at which the Bank could source the funds from local lenders. As a result of such financing, the Bank is able to advance funds to specific customers at advantageous rates. As the transactions are with unrelated parties, management's judgement is that these funds and the related lending are at the market interest rates and no initial recognition of gains or losses should arise. In making this judgement management also considered that these instruments are a separate market segment.

Loans at low interest rates. Management have considered the appropriate market interest rate for certain loans and advances where the contractual interest rate is eight per cent or lower. Management have assessed that the contractual interest rates for these loans are equivalent to the alternative highest and best use of the funds provided under these loans, the majority of which are with Government bodies and state-owned entities. Had management concluded that the interest rates for these borrowings were different to the highest and best use of the funds provided, then the carrying amounts in respect of these loans in the financial statements, and the amounts recorded within interest income and losses on the origination of loans, would have been different.

Finance leases and derecognition of financial assets. Management applies judgement to determine if substantially all the significant risks and rewards of ownership of financial assets and lease assets are transferred to counterparties, in particular which risks and rewards are the most significant and what constitutes substantially all risks and rewards.

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

Tax legislation. Azerbaijani tax, currency and customs legislation is subject to varying interpretations.

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

Capital Adequacy ratio. Capital Adequacy Ratio is calculated in accordance with the International Convergence of Capital Measurement and Capital Standards (July 1988, updated to November 2005) (or Basel Capital Accord) requirements. Such requirements are subject to interpretation and accordingly the appropriateness of the inclusion, exclusion, and/or classification of amounts included in the calculation of the Capital Adequacy Ratio requires management judgment, for example, treatment of off-balance sheet commitments.

5 Adoption of New or Revised Standards and Interpretations

Certain new IFRSs became effective for the Organization from 1 January 2008.

- **IFRIC 11, IFRS 2—Organization and Treasury Share Transactions** (effective for annual periods beginning on or after 1 March 2007);
- **IFRIC 12, Service Concession Arrangements** (effective for annual periods beginning on or after 1 January 2008); and
- **IFRIC 14, IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction** (effective for annual periods beginning on or after 1 January 2008).

These interpretations did not have any significant effect on the Organization's financial statements.

Reclassification of Financial Assets—Amendments to IAS 39, Financial Instruments: Recognition and Measurement, and IFRS 7, Financial Instruments: Disclosures and a subsequent amendment, Reclassification of Financial Assets: Effective Date and Transition. The amendments allow entities the options (a) to reclassify a financial asset out of the held to trading category if, in rare circumstances, the asset is no longer held for the purpose of selling or repurchasing it in the near term; and (b) to reclassify an available-for-sale asset or an asset held for trading to the loans and receivables category, if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity (subject to the asset otherwise meeting the definition of loans and receivables). The amendments may be applied with retrospective effect from 1 July 2008 for any reclassifications made before 1 November 2008; the reclassifications allowed by the amendments may not be applied before 1 July 2008 and retrospective reclassifications are only allowed if made prior to 1 November 2008. Any reclassification of a financial asset made on or after 1 November 2008 takes effect only from the date when the reclassification is made.

6 New Accounting Pronouncements

Certain new standards and interpretations have been published that are mandatory for the Organization's accounting periods beginning on or after 1 January 2008 or later periods and which the Organization has not early adopted:

IFRS 8, Operating Segments (effective for annual periods beginning on or after 1 January 2009).

The standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments and specifies how an entity should report such information. The Organization is currently assessing what impact the standard will have on segment disclosures in the financial statements.

Puttable financial instruments and obligations arising on liquidation—IAS 32 and IAS 1 Amendment (effective from 1 January 2009). The amendment requires classification as equity of some financial instruments that meet the definition of a financial liability. The Organization is currently assessing the impact of the amendment on its financial statements.

IAS 23, Borrowing Costs (revised March 2007; effective for annual periods beginning on or after 1 January 2009). The revised IAS 23 was issued in March 2007. The main change to IAS 23 is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalise such borrowing costs as part of the cost of the asset. The revised standard applies prospectively to borrowing costs relating to qualifying assets, for which the commencement date for capitalisation is on or after 1 January 2009. The Organization is currently assessing the impact of the amended standard on its financial statements.

IAS 1, Presentation of Financial Statements (revised September 2007; effective for annual periods beginning on or after 1 January 2009). The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which will also include all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities will be allowed to present two statements: a separate income statement and a statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at

the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The Organization expects the revised IAS 1 to affect the presentation of its financial statements, but to have no impact on the recognition or measurement of specific transactions and balances.

IAS 27, and Separate Financial Statements (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously “minority interests”) even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent’s ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Organization is currently assessing the impact of the amended standard on its financial statements.

Vesting Conditions and Cancellations—Amendment to IFRS 2, Share-based Payment (issued in January 2008; effective for annual periods beginning on or after 1 January 2009). The amendment clarifies that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The Organization is currently assessing the impact of the amended standard on its financial statements.

IFRS 3, Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree’s identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations.

The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer will have to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss.

Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. IFRS 3 is not relevant to the Organization as it does not expect a business combination to occur.

IFRIC 13, Customer Loyalty Programmes (effective for annual periods beginning on or after 1 July 2008). IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values. The Organization does not operate any loyalty programmes.

IFRIC 15, Agreements for the Construction of Real Estate (effective for annual periods beginning on or after 1 January 2009). The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions. IFRIC 15 is not relevant to the Organization’s operations because it does not have any agreements for the construction of real estate.

IFRIC 16, Hedges of a Net Investment in a Foreign Operation (effective for annual periods beginning on or after 1 October 2008). The interpretation explains which currency risk exposures are eligible for hedge accounting and states that translation from the functional currency to the presentation currency does not create an exposure to which hedge accounting could be applied. The IFRIC allows the hedging instrument to be held by any entity or entities within a Organization except the foreign operation that itself is being hedged. The interpretation also clarifies how the gain or loss recycled from the currency translation reserve to profit or loss is calculated on disposal of the hedged foreign operation. Reporting

entities will apply IAS 39 to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in IFRIC 16. IFRIC 16 does not have any impact on these financial statements as the Organization does not apply hedge accounting.

Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate—IFRS 1 and IAS 27 Amendment (issued in May 2008; effective for annual periods beginning on or after 1 January 2009). The amendment allows first-time adopters of IFRS to measure investments in subsidiaries, jointly controlled entities or associates at fair value or at previous GAAP carrying value as deemed cost in the separate financial statements. The amendment also requires distributions from pre-acquisition net assets of investees to be recognised in profit or loss rather than as a recovery of the investment. The amendments will not have any impact on the Organization's financial statements.

Eligible Hedged Items—Amendment to IAS 39, Financial Instruments: Recognition and Measurement (effective with retrospective application for annual periods beginning on or after 1 July 2009). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment is not expected to have any impact on the Organization's financial statements as the Organization does not apply hedge accounting.

Improvements to International Financial Reporting Standards (issued in May 2008). In 2007, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS. The amendments issued in May 2008 consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting. The Organization does not expect the amendments to have any material effect on its financial statements.

IFRIC 17, Distribution of Non-Cash Assets to Owners (effective for annual periods beginning on or after 1 July 2009). The amendment clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss when the entity settles the dividend payable. IFRIC 17 is not relevant to the Organization's operations because it does not distribute non-cash assets to owners.

IFRS 1, First-time Adoption of International Financial Reporting Standards (following an amendment in December 2008, effective for the first IFRS financial statements for a period beginning on or after 1 July 2009). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The Organization concluded that the revised standard does not have any effect on its financial statements.

IFRIC 18, Transfers of Assets from Customers (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers.

Improving Disclosures about Financial Instruments- Amendment to IFRS 7, Financial Instruments:

Disclosures (effective for annual periods beginning on or after 1 January 2009; not yet adopted by the EU). The amendment requires enhanced disclosures about fair value measurements and liquidity risk. The entity will be required to disclose an analysis of financial instruments using a three-level fair value measurement hierarchy. The amendment (a) clarifies that the maturity analysis of liabilities should include issued financial guarantee contracts at the maximum amount of the guarantee in the earliest period in which the guarantee could be called; and (b) requires disclosure of remaining contractual maturities of financial derivatives if the contractual maturities are essential for an understanding of the timing of the cash flows. An entity will further have to disclose a maturity analysis of financial assets it holds for managing liquidity risk, if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk.

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7 Cash and Cash Equivalents

<i>In Azerbaijani Manats</i>	2009	2008
Cash on hand	3,750	1,652
Cash balances with the National/Central banks (other than mandatory reserve deposits)		
Correspondent accounts and overnight placements with other banks		
- The Azerbaijan Republic	6,057	21,305
- Other countries		
Total cash and cash equivalents	9,807	22,957

The balances on correspondent accounts of the Organization amounting to AZN 9,807 as at 31 December 2009 (2008: AZN 22,957), respectively.

The analysis by credit quality of the cash and cash equivalents at 31 December 2009 is as follows:

<i>In Azerbaijani Manats</i>	Cash on hand	Cash balances with the National/Central banks	Correspondent accounts and overnight placements with other banks	Total
<i>Current and not impaired</i>				
- Cash on hand	3,750	-	-	3,750
- National Bank of the Azerbaijan Republic	-	-	-	-
- Central Bank of the Russian Federation	-	-	-	-
- National Bank of the Republic of Georgia	-	-	-	-
- Top 15 Azerbaijani banks	-	-	6,057	6,057
- Other Azerbaijani banks	-	-	-	-
- OECD banks	-	-	-	-
- Non-OECD banks	-	-	-	-
Total cash and cash equivalents	3,750	-	6,057	9,807

The analysis by credit quality of the cash and cash equivalents at 31 December 2008 is as follows:

<i>In Azerbaijani Manats</i>	Cash on hand	Cash balances with the National/Central banks	Correspondent accounts and overnight placements with other banks	Total
<i>Current and not impaired</i>				
- Cash on hand	1,652	-	-	1,652
- National Bank of the Azerbaijan Republic	-	-	-	-
- Central Bank of the Russian Federation	-	-	-	-
- National Bank of the Republic of Georgia	-	-	-	-
- Top 15 Azerbaijani banks	-	-	21,305	21,305
- Other Azerbaijani banks	-	-	-	-
- OECD banks	-	-	-	-
- Non-OECD banks	-	-	-	-
Total cash and cash equivalents	1,652	-	21,305	22,957

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Notes to the Financial Statements – 31 December 2009

8 Loans and Advances to Customers

<i>In Azerbaijani Manats</i>	2009	2008
Corporate loans		
Loans to individuals - consumer loans	152,698	19,704
Loans to individuals – entrepreneurs	266,543	76,696
Mortgage loans		
Reverse sale and repurchase agreements		
State and municipal organisations		
Less: Provision for loan impairment	(8,352)	(1,881)
Total loans and advances to customers	410,889	94,518

Movements in the provision for loan impairment during 2009 are as follows (2008: AZN 1,881):

<i>In Azerbaijani Manats</i>	Provision for loan impairment at 1 January 2009	Increase in/ (Recovery of) provision for impairment During the year	Provision for loan impairment at 31 December 2009
Corporate loans	-	-	-
State and public organisations	-	-	-
Loans to individuals and private enterprises	1,881	6,471	8,352
Total	1,881	6,471	8,352

Economic sector risk concentrations within the customer loan portfolio are as follows:

<i>In Azerbaijani Manats</i>	2009		2008	
	Amount	%	Amount	%
Agriculture	1,271	0.3	3,472	3.6
Service	8,307	2.0	3,309	3.4
Trade	257,598	61.5	69,915	72.5
Other	152,064	36.2	19,704	20.5
Total loans and advances to customers (before impairment)	419,241	100.0	96,399	100.0

The balance of the loan issued to the customers amounted by AZN 419,241 as of 31 December 2009 (2008: AZN 96,399), where accrued interest was AZN 2,891 (2008: AZN 2,750) and provision impaired for loans was AZN 8,352 (2008: 1,881) by the same date.

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Notes to the Financial Statements – 31 December 2009

9 Premises, Equipment and Intangible Assets

<i>In Azerbaijani Manats</i>	Office equipment and computers	Furniture, fixtures, vehicles & other	Total premises and equipment	Intangible assets	Total
Cost or valuation at 1 January 2008	-	-	-	-	-
Accumulated depreciation					
Carrying amount at 1 January 2008	-	-	-	-	-
Additions	3,020	-	3,020	-	3,020
Transfers	-	-	-	-	-
Disposals	-	-	-	-	-
Depreciation charge	(37)	-	(37)	-	(37)
Revaluation / Repair	-	-	-	-	-
Carrying amount at 31 December 2008	2,983	-	2,983	-	2,983
Cost or valuation at 31 December 2008	-	-	-	-	-
Accumulated depreciation	-	-	-	-	-
Carrying amount at 31 December 2008	2,983	-	2,983	-	2,983
Additions	510	4,500	5,010	-	5,010
Disposals	-	-	-	-	-
Depreciation charge	(777)	-	(777)	-	(777)
Revaluation / Repair	255	-	255	-	255
Carrying amount at 31 December 2009	2,971	4,500	7,471	-	7,471
Cost or valuation at 31 December 2009	-	-	-	-	-
Accumulated depreciation	-	-	-	-	-
Carrying amount at 31 December 2009	2,971	4,500	7,471	-	7,471

The net amount of office equipment and computers was AZN 7,471 as of 31 December 2009 (2008:AZN 2,983), where depreciation charge for the year was recalculated as AZN 777 (2008: AZN 37). The Organization has no other fixed assets and intangible assets available.

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10 Other Assets

The Organization has receivables from State Budget by AZN 290 as of 31 December 2009 (2008: AZN 290) which is recognized as other assets. At 31 December 2009 Organization has accrued expenses of AZN 5617.

11 Other Borrowed Funds

<i>In Azerbaijani Manats</i>	2009	2008
Qafqaz Kredit	86,000	56,000
Zamin Bank (Khazar Branch)	-	40,000
Texnika Bank	114,248	-
Alfa Insurance	150,000	-
Accrued interest payable	-	-
Total other borrowed funds	350,248	96,000

On 15 January 2009, Organization signed loan agreement with Qafqaz Kredit in the amount of AZN 86,000. The borrowing facility bears a market interest rate of 18% and is repayable within two years. Organization will utilize amounts borrowed under this agreement to issue loans to its customers. As at 31 December 2009 the outstanding balance of this loan was amounted by AZN 86,000. (31 December 2008: AZN 56,000 balance due to previous agreement which was fully repaid in 2009).

The Organization signed loan agreement with Texnika Bank in the amount of USD 80,000 and AZN 50,000 as a credit line on March, August, September and October 2009 partially. The borrowing facility bears a market interest rate of 18% and is repayable within twelve months. Organization will utilize amounts borrowed under this agreement to issue loans to its customers. As at 31 December 2009 the outstanding balance of this loan was amounted by AZN 114,248 (31 December 2008: nil).

On 20 November 2009 Organisation sold one half of its securities to Alfa Insurance for AZN 150,000, bearing 14% annual interest for 24 month period (31 December 2008: nil).

12 Other Liabilities

<i>In Azerbaijani Manats</i>	2009	2008
Taxes payable other than on income	899	501
Accrued employee benefit costs	967	107
Deferred consideration for acquisitions	-	-
Deferred income	-	-
Other	2,317	68
Total other liabilities	4,183	676

At 31 December 2009 the Organization has other liabilities to State Budget, State Pension Fund and liabilities due to items by AZN 899, AZN 967 and AZN 2,317 respectively (31 December 2007: AZN 501, AZN 107 and AZN 68)

13 Other Reserves

On 10 November 2005 "Normicro NBCO" have issued grant amounted USD 5,000 (AZN 4,598) and the Organization utilized amounts borrowed to issue loans to its customers. Additional AZN 1,880 (in 2008) and AZN 4,500 (in 2009) of capital reserves were created due to the contribution of shareholder for acquisition of office equipment and computers.

The balance of Other Reserves was amounted by AZN 10,978 as of 31 December 2009 (2008: AZN 6,478)

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Notes to the Financial Statements – 31 December 2009

14 Interest Income and Expense

<i>In Azerbaijani Manats</i>	2009	2008
Interest income		
Loans and advances to customers	63,914	9,450
Due from other banks and correspondent accounts	-	-
Other	-	-
Total interest income	63,914	9,450
Interest expense		
Deposits from banks and other borrowed funds	21,036	2,050
Subordinated debt	-	-
Other	-	-
Total interest expense	21,036	2,050
Net interest income/[(negative interest margin)]	42,878	7,400

15 Fee and Commission Income and Expense

<i>In Azerbaijani Manats</i>	2009	2008
Fee and commission income		
- Transactions with foreign currencies and securities	-	-
- Cash transactions	-	-
- Settlement transactions	-	-
- Servicing intermediary loans	14,292	2,800
- Other	-	-
Total fee and commission income	14,292	2,800
Fee and commission expense		
- Cash transactions	1,115	-
- Settlement transactions	-	-
- Plastic cards operations	-	-
- Policy acquisition costs on insurance operations	-	-
- Other	1,320	-
Total fee and commission expense	2,445	-
Net fee and commission income	11,847	2,800

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Notes to the Financial Statements – 31 December 2009

16 Administrative and Other Operating Expenses

<i>In Azerbaijani Manats</i>	Note	2009	2008
Staff costs		40,754	4,770
Depreciation of premises and equipment	9	777	37
Expenses related cheques and cash		940	-
Advertising and marketing services		4	-
Customs duties and other taxes other than on income		-	-
Rent		800	-
Maintenance of premises and equipment		30	143
Security		-	-
Communication		1,220	750
Stationery, books, printing and other supplies		1,484	1,627
Consultancy, audit and other professional fees		1,466	500
Membership fees		1,500	-
Business trip expenses		2,212	-
Software related expenses		50	-
Training		-	-
Other		433	-
Total administrative and other operating expenses		51,670	7,899

Included in staff costs are obligatory payments to the Social Security Fund and other funds of the Republic of Azerbaijan of AZN 40,754 as of 31 December 2009 (31 December 2008: AZN 4,770). The amount of AZN 10,916 was expensed for Communication, Office Supply, Audit Expenses, Membership fees, Depreciation charges and others expenses (31 December 2008: AZN 3,129).

17 Income Taxes

Income tax expense comprises the following:

<i>In Azerbaijani Manats</i>	2009	2008
Current tax	-	-
Deferred tax	327	-
Income tax expense for the year	327	-

The income tax rate applicable to the majority of the Organisation's income is 22% at 31 December 2009 (2008: 22%).

18 Segment Analysis

Business segments. The Organization is organised only on a basis of Retail Banking segment, representing consumer loans to individuals and entrepreneurs.

Geographical segments. The Organization's operations outside of Republic of Azerbaijan are not considered significant and do not meet the definition of separately reportable segments.

19 Financial Risk Management

The Organization has exposure to financial risks which include credit, liquidity, market and operational risks. The taking of risk is integral to the Organization's business. The Organization's risk management function's aim is to achieve an appropriate balance between risk and return and to minimise potential adverse effects on the Organization's financial performance.

The risk management framework. The risk management function is an integral part of the Organization's internal control system and is centralised. The Organization's risk management policies and approaches aim to identify, analyse, mitigate and manage the risks faced by the Organization. This is accomplished through setting appropriate risk limits and controls, continuously monitoring risk levels and the adherence to limits and procedures and ensuring that business processes are correctly formulated and maintained.

Risk Management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and to ensure that "best practices" are implemented. The Organization, as part of its risk culture, emphasises integrity, management and employee standards in order to maintain and continuously improve upon a conservative control environment.

Risk management bodies and governance. Risk management policy, assessment, approval, monitoring and controls are conducted by a chief accountant within the Organization.

The Supervisory Board of the Organization has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing and approving risk management policies as well as several key risk limit approval authorities, including significantly large exposures, economic and product sector limits. It also delegates certain authority levels to the Managing Director and Credit Committee.

The Managing Director is responsible for the implementation and monitoring of risk mitigation measures and ensuring that the Organization operates within the established risk parameters. Managing Director is responsible for risk management along with the Chief Accountant, who reports to Managing Director, are responsible for the overall risk management functions, ensuring the implementation of common principles and methods for identifying, measuring, mitigating, managing and reporting both financial and non-financial risks.

The Credit Committee consists of four members: Managing Director, Chief accountant and Credit specialists. The Credit specialist, who offers the loan issue, can not vote on Credit Committee for the approval of the same loan. The Credit Committee manages and approves, or recommends for approval, retail clients' counterparty credit risk exposures within its credit approval authority. It also continuously reviews and makes recommendations as to analysis methodology and portfolio quality, including overall structure, diversification and pricing. The Credit Committee is one of the bodies which ensures adherence to all approval and authority limits and high standards for risk analysis and assessments.

Credit risk. Credit risk is the risk of financial loss to the Organization if a customer or counterparty fails to meet its contractual obligations when due. The major portion of credit risk arises from the Organizations' loans and advances to customers and banks and other on and off balance sheet credit exposures. For risk reporting purposes, the Organization considers and consolidates all elements of credit risk exposures such as individual customer and counterparty default risk and industry risk. At present, the credit risk arising from securities markets operations is Azerbaijani government bonds, the notes issued by the CBAR, and held-to-maturity investment securities purchased from foreign financial institutions. These securities are used exclusively to help manage the liquidity position of the Organization.

The general credit risk approval structure, for corporate legal entities, private individuals and financial organisations, is as follows:

Supervisory Board	The Supervisory Board reviews and approves limits above AZN 20,000.
Credit Committee	The Credit Committee reviews and approves limits below AZN 20,000.

The Supervisory Board also approves general limits so as to control and manage risk diversification:

- Portfolio limits: Loans to entrepreneurs above AZN 20,000;
- Economic sector and product exposures: above AZN 20,000.
-

Credit risk management. Credit risk policy is developed by the Credit Department and Managing Director in line with the risk profile and strategic plans of the Organization. It is approved by the Supervisory Board.

This policy establishes:

- Procedures for generating, analysing, reviewing and approving counterparty risk exposures;
- The methodology for the credit assessment of counterparties;
- The methodology for the credit rating of counterparties;
- The methodology for the evaluation and control of collateral;
- Credit documentation requirements;
- Loan administration procedures;
- Procedures for the ongoing monitoring of credit exposures;
- Environmental policy; and
- Loan loss provisioning policy.

Loan/credit requests are originated and generated by client managers and credit inspectors. Credit applications within approved authority limits are approved by the branches or relevant business generating units. Then copies of these approved requests are submitted to the Credit Department for post-control, including being assigned a rating and input into a monitoring schedule. Risk exposure requests above these limits are sent to the Credit Committee. The Credit Committee performs a secondary analysis and issues a report, rating and opinion. If the credit request is below a certain authorised limit and receives a positive opinion from the Credit Committee, and is signed off by the appropriate individuals, then the request is considered approved. If the opinion of risk management is negative then the request is sent to the Credit Committee for adjudication. If approved and the transaction is in an amount higher than the competence of the Credit Committee then it is sent to the Managing Director for approval. Large transactions, as defined above, have to be submitted to the Supervisory Board for approval.

The Organization uses a rating system based on an analysis of four basic criteria: creditworthiness, financial performance, credit history and other risks.

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

For certain retail loan products, a credit scoring system is used, plus the Organization uses its internal database and that of the CBAR to identify potentially risky customers. Credit assessments are done on a portfolio basis concentrating on amount and term limits, approval procedures, target Organizations, types of product, default statistics, loan/value ratios (if applicable), and pricing.

Collateral and other credit enhancements. Exposure to credit risk is also assessed and managed, in part, by obtaining, controlling and monitoring collateral in the form of mortgage interests over property, pledge of assets and securities and other collateral including deposits, corporate and personal guarantees.

While collateral is an important mitigating factor in assessing the credit risk, it is the Organization's policy to establish that loans are within the customer's capacity to repay rather than to rely solely on security. Collateral is considered as a secondary source of repayment. In limited cases, depending on the customer's standing or on the type of product or amounts, the facilities may be unsecured. The Organization has in place various limits on the unsecured portions of its risk portfolio.

The principal types of collateral accepted by the Organization are as follows:

- Commercial real estate
- Residential real estate
- Transport vehicles
- Other including precious metals.

Strict appraisal, documentation and, where applicable, registration procedures are in place for all forms of collaterals. Loan to value ratios are approved by the Managing Director and controlled by the Credit Department. The loan to value limits as of 31 December 2009 are as follows:

Type of collateral	Ratio of loan amount to liquid value of collateral
Real estate	up to 60%
Precious metals	up to 90%
Vehicles, transport	up to 70%

However, management notes that the above limits may at certain times be overridden based on commercial considerations.

The Credit Department is responsible for establishing a schedule of monitoring events, fulfilling this plan and notifying the appropriate parties if the monitoring results are unsatisfactory and recommending a plan of action. The Credit Department physically monitors all transactions above an established amount plus does selected checks of transactions below this amount. All transactions above a certain amount are first monitored either before or at least within one month of disbursement. Following this, risk exposures are monitored according to a schedule.

The Credit Department is charged with compiling and reporting on all counterparty credit risk issues, including compliance with all limits, risk concentrations, portfolio trends, past due and default statistics, loan loss reserves and collateral statistics. Besides regular monthly reporting, they also compile reports on adherence to selected credit procedures.

Past due, non-performing loans. The Organization has in place procedures for reporting and dealing with past-due and non-performing loans from the first day past-due. Up to 60-day past-dues are all handled by the relevant business units unless obvious problems are identified earlier. Unsecured retail loans over 60-days past-due are automatically transferred to the Problematic Loans Department. Corporate loans over 90-days past-due are also transferred to this department. All loans are placed on non-accrual after 90 days past due. If the Problematic Loans Department is unsuccessful in collecting on these obligations, then legal proceedings are instituted. When a loan is deemed uncollectible, recommendations to write-off these amounts are presented to the Credit Committee and the Executive Board. Final decisions regarding write-offs are taken by the Supervisory Board.

All past-dues statistics are reported to the Credit Committee on at least a monthly basis. All corporate loan past-due issues are individually reported to the Credit Committee.

Allowance for loan losses – reserve policy. The Organization establishes an allowance for loan losses that represents its estimate of losses incurred in its risk exposures.

The CBAR also has a reserve policy, which is a minimum standard for banks. The categories with reserve requirements are as follows:

Standard assets	1%
Controllable assets	10%
Unsatisfactory assets	30%
Assets-at-risk	60%
Hopeless assets	100%

These categories are strictly defined.

In its IFRS reporting, the Organization utilises the methodology contained in IAS 39 – *Financial Instruments: Recognition and Measurement*.

Maximum exposure to credit risk. The Organization's maximum exposure to on balance sheet credit risk is generally reflected in the carrying amounts of financial assets on the balance sheet. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

Management of insurance risks

- **Insurance risk.** The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and, therefore, unpredictable for each individual insurance contract.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Organization faces under its insurance contracts is that the actual claims and benefit payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits may be greater than estimated. Insured events are random and the actual number and amount of claims and benefits will vary from year to year from the level established using statistical techniques.

The Organization manages its insurance risk by means of established internal procedures which include underwriting authority levels, pricing policy, approved re-insurers list and ongoing monitoring.

- **Estimation of insurance loss reserves.** Loss provisions are calculated based on the Organization's historical data. In calculating the estimated cost of unpaid claims (both reported and not), the Organization's estimation techniques include a combination of loss ratio-based estimates (where the loss ratio is defined as the ratio between the ultimate cost of insurance claims and insurance premiums earned in a particular financial year in relation to such claims) and an estimate based upon actual claims experience using predetermined formulae where a greater weight is given to actual claims experience as time passes.

The initial loss ratio estimate is an important assumption in the estimation technique and is based on previous years' experience, adjusted for factors such as premium rate changes, anticipated market experience and historical claims inflation. The initial estimate of the loss ratios used for the current year (before reinsurance) are analysed by type of risk for current and prior year premiums earned.

- **Sources of uncertainty in the estimation of future claim payments.** Claims on insurance contracts are payable on a claims-occurrence basis. The Organization is liable for all insured events that occurred during the term of the contract, if the loss is discovered before the end of the contract term. As a result, liability claims are settled within a short period of time, which historically has not exceeded 3 months from the end of the contract term. There are several variables that affect the amount and timing of cash flows from insurance contracts. These mainly relate to the inherent risks of the activities carried out by both corporate and individual contract holders and the risk management procedures they adopted. The compensation paid on insurance contracts in the Organization's portfolio primarily consists of monetary awards granted for:
 - medical insurance;
 - physical damage to motor vehicles (for motor vehicle insurance covers); and
 - financial loss, bodily injury and physical damage suffered by the third parties (caused by the vehicle owners).

Such awards are lump-sum payments that are calculated by the Organization's in-house underwriters as the present value of the lost earnings and rehabilitation expenses that the injured party will incur as a result of the accident.

- **Reinsurance policy.** An element of the Organization's motor, property, third party liability, employer liability and cargo portfolios is reinsured with local and foreign insurance companies under reinsurance agreements that reduce the potential maximum exposure that the Organization is subject to.
- **Diversification.** Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected by a change in any subset of the portfolio. The Organization has developed its insurance underwriting strategy to diversify the type of insurance risks accepted and within each of these categories to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

Market risk. The Organization is exposed to market risks. Market risks arise from open positions in interest rates, currency and equity products, all of which are exposed to general and specific market movements. The Organization manages market risk through policies of very limited exposures to these risks and periodic estimations of the Organization's positions regarding these risks.

The Organization does not have any trading positions in financial instruments. Its exposure to the securities market is the investment, from time to time, in the CBAR notes, Azerbaijan Ministry of Finance obligations and securities issued by other banks in order to help manage its liquidity position. The Organization does not normally trade in the derivatives market and has no exposure to this market.

Currency risk. 16% loan portfolio expressed in USD vs. whole portfolio was in AZN previous year. As CBAR is strictly keeps exchange rate of USD stable, currency risk is not affecting the Organization's income or the value of its portfolios.

Exposure to foreign exchange risk faced by the Organization is also being limited by the CBAR normative requirements, which place a 10% of capital limit on open positions in any single foreign currency and a 20% open limit on all foreign currencies.

Interest rate risk. The Organization takes on exposure to the effects of fluctuations in the prevailing levels of 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. Management monitors on a daily basis and sets limits on the level of mismatch of interest rate re-pricing that may be undertaken.

At present, the Organization manages its interest rate risk by matching, where possible, its maturity and/or re-pricing positions. In addition, the Organization's monthly interest margins are continually reviewed in order to re-price its assets when deemed appropriate. Operational procedures set the acceptable interest rate margin usually at a minimum 5%. ALCO At present, through the Organization's matching policies for expected re-pricing and relatively high interest rate margins achieved in the Organization's markets, the Organization does not more actively manage this risk.

Geographical risk concentrations. The geographical concentration of the Organization's financial assets and liabilities at 31 December 2009 and 31 December 2008 are fully set in Azerbaijani Manats.

Assets, liabilities have generally been based on the country located. Cash on hand and premises and equipment have been allocated based on the country, in which they are physically held.

Other risk concentrations. As a part of its management of risk concentrations, management monitors concentrations of credit risk on the basis of the statutory limits set by the CBAR, as follows:

- The aggregate amount of loans, the fair value of the collateral of which is greater than the carrying amount of the loan, may not exceed 25% of the total statutory capital calculated in accordance with the CBAR's guidance;
- The aggregate amount of loans, the fair value of the collateral of which is less than the carrying amount of the loan, may not exceed 10% of the total statutory capital calculated in accordance with the CBAR's guidance; and

For IFRS reporting purposes, the Organization, monitors concentrations of credit risk by obtaining reports listing exposures to borrowers with aggregated loan balances in excess of 10% of net assets. The Organization discloses any such concentrations within the respective notes in its financial statements.

Liquidity risk. Liquidity risk is the risk that the Organization will encounter difficulty in settling its financial obligations. It refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of financial institutions.

In order to manage liquidity risk, the Organization performs daily monitoring of future expected cash flows on clients' and banking operations, which is part of the assets/liabilities management process. The Supervisory Board and Managing Director set limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of inter-bank and other borrowing facilities that should be in place to cover withdrawals under both normal and stressed conditions. They also set parameters for the risk diversification of the liability base.

The CBAR has in place minimum levels of liquidity required. Loan agreements with international financial institutions also have minimum liquidity covenants in their agreements with the Organization. As of 31 December, 2009, management consider that the Organization was in compliance with all these covenants.

The Organization's liquidity policy is comprised of the following:

- Projecting cash flows and maintaining the level of liquid assets necessary to ensure liquidity in various time-bands;
- Maintaining a funding plan commensurate with the Organization's strategic goals;
- Maintaining a diverse range of funding sources thereby increasing the Organization's borrowing capacity, domestically as well as from foreign sources;
- Maintaining highly liquid and high-quality assets;
- Adjusting its product base by time bands against available funding sources;
- Daily monitoring of liquidity ratios against regulatory requirements; and

20 Subsequent Events

Subsequent to the balance sheet date, the Organization switched to automated banking system. The new system is expected to enhance the operational effectiveness of the Organization.

The Organization has already started to issue loans in United States Dollars (“USD”)

The Organization is also going to expand its operations in the regions via funding by IFAD through State Agency on Agricultural Loans to issue loans to agricultural sector and attract lower cost funds from foreign institutions as Blueorchard, Oikocredit, etc.