

**FINCA Azerbaijan LLC**

Financial Statements  
for the Year Ended 31 December 2010  
and Independent Auditor's Report

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## Independent Auditor's Report

To the Shareholders and the Supervisory Board of FINCA Azerbaijan LLC

We have audited the accompanying financial statements of FINCA Azerbaijan LLC, which comprise the statement of financial position as at 31 December 2010, and the statement of comprehensive income, statement of cash flows and statement of changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### Management's Responsibility for the Financial Statements

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

### Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit.

The financial statements for the year ended 31 December 2009 were audited by another auditor whose report dated 11 March 2010 expressed an unqualified opinion.

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 FINCA Azerbaijan LLC as at 31 December 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

### Emphasis of matter

Without qualifying our opinion we draw your attention to Note 11 to the financial statements. Azerbaijani tax system is immature and provisions of national tax legislation may be subject to varying interpretations. The management believes it has prudently applied provisions of national tax legislation and there is no need for accrual of additional tax liabilities. There is a risk, however, that tax authorities during their next field audit may dispute management's implementation of certain provisions of the national Tax Code. As of the date of this audit opinion, we are unable to quantify the amount of additional liability for taxes that may be imposed by tax authorities.

*BDO Azerbaijan LLC*

7 March 2011

## Statement of Management's Responsibilities for the Preparation and Approval of the Financial Statements for the Year Ended 31 December 2010

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

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Company as at 31 December 2010, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards (IFRS).

In preparing the financial statements, management is responsible for:

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

Management is also responsible for:

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

On behalf of the Company's management the financial statements for the year ended 31 December 2010 were authorized for issue on 7 March 2011 by:



Manish Sane  
Chief Executive Officer



Elshan Gurbanov  
Finance and Accounting Manager

FINCA Azerbaijan LLC  
Baku, Azerbaijan



**FINCA Azerbaijan LLC**  
**Statement of Financial Position as at 31 December 2010**  
in thousands of United States Dollars, unless otherwise indicated

	Note	2010	2009	2008
<b>Assets</b>				
Cash and cash equivalents	6	7,330	10,552	3,383
Loans to customers	7	82,007	67,184	65,743
Other receivables, prepaid expenses and other assets	8	578	3,590	1,019
Property and equipment	9	916	893	732
Intangible assets	10	3,194	3,769	2,185
Current income tax asset	11	-	147	-
Deferred income tax assets	11	876	804	969
<b>Total assets</b>		<b>94,901</b>	<b>86,939</b>	<b>74,031</b>
<b>Liabilities</b>				
Notes payable	12	66,066	60,646	58,326
Subordinated debt	13	7,081	7,080	-
Current income tax liability	11	993	-	56
Other liabilities	14	1,856	4,011	3,592
<b>Total liabilities</b>		<b>75,996</b>	<b>71,737</b>	<b>61,974</b>
<b>Equity</b>				
Share capital	15	5	5	5
Retained earnings		18,900	15,197	12,052
<b>Total equity</b>		<b>18,905</b>	<b>15,202</b>	<b>12,057</b>
<b>Total liabilities and equity</b>		<b>94,901</b>	<b>86,939</b>	<b>74,031</b>

\_\_\_\_\_  
Manish Sane  
Chief Executive Officer

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Elshan Gurbanov  
Finance and Accounting Manager

7 March 2011



The notes set out on pages 9 to 35 are an integral part of these financial statements.

**FINCA Azerbaijan LLC**  
**Statement of Comprehensive Income for the Year Ended 31 December 2010**  
*in thousands of United States Dollars, unless otherwise indicated*

	Note	2010	2009
Interest and similar income	16	31,104	27,715
Interest and similar expenses	16	(6,595)	(6,260)
<b>Net interest income</b>		<b>24,509</b>	<b>21,455</b>
Provision for impairment of loans to customers	7	(54)	(511)
<b>Net interest income after loan impairment charges</b>		<b>24,455</b>	<b>20,944</b>
Personnel expenses	17	(10,967)	(10,275)
General and administrative expenses	18	(5,627)	(4,643)
Depreciation and amortization expenses	9,10	(1,253)	(576)
Results from foreign exchange transactions		(8)	(233)
Other operating expenses	19	(81)	(1,019)
Other operating income		70	28
<b>Operating profit</b>		<b>6,589</b>	<b>4,226</b>
Donations made	20	(1,420)	-
<b>Profit for the year before tax</b>		<b>5,169</b>	<b>4,226</b>
Income tax expense	11	(1,466)	(1,081)
<b>Net profit for the year</b>		<b>3,703</b>	<b>3,145</b>
<b>Total comprehensive income for the year</b>		<b>3,703</b>	<b>3,145</b>

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 Manish Sane  
 Chief Executive Officer

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 Elshan Gurbanov  
 Finance and Accounting Manager

7 March 2011



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**FINCA Azerbaijan LLC**  
**Statement of Cash Flows for the Year Ended 31 December 2010**  
*in thousands of United States Dollars, unless otherwise indicated*

	Note	2010	2009
<b>Cash flows from operating activities</b>			
Profit before tax		5,169	4,226
<i>Non-cash items included in the profit for the year and transition to the cash flow from operating activities</i>			
Depreciation and amortization		1,253	576
Impairment on financial assets		54	511
Foreign exchange losses		17	102
		<b>6,493</b>	<b>5,415</b>
<i>Increase/decrease of assets and liabilities from operating activities after non-cash items</i>			
Change in loans to customers		(14,875)	(1,619)
Change in other receivables, prepaid expenses and other assets		3,013	(3,013)
Change in other liabilities		(2,154)	419
<b>Cash flows from operating activities before taxation</b>		<b>(7,523)</b>	<b>1,202</b>
Income taxes paid		(400)	(1,118)
<b>Cash flows from operating activities</b>		<b>(7,923)</b>	<b>84</b>
<b>Cash flows from investing activities</b>			
Purchase of property and equipment		(403)	(487)
Purchase of intangible assets		(529)	(1,677)
Proceeds from sales/disposal of fixed assets		6	-
<b>Net cash used in investing activities</b>		<b>(926)</b>	<b>(2,164)</b>
<b>Cash flows from financing activities</b>			
Proceeds from borrowings		21,462	24,004
Borrowings repaid		(15,835)	(14,755)
<b>Net cash from financing activities</b>		<b>5,627</b>	<b>9,249</b>
<b>Net (decrease) / increase in cash and cash equivalents</b>		<b>(3,222)</b>	<b>7,169</b>
Cash and cash equivalents at the beginning of the year	6	10,552	3,383
<b>Cash and cash equivalents at the end of the year</b>	<b>6</b>	<b>7,330</b>	<b>10,552</b>

Manish Sane  
 Chief Executive Officer

Elshan Gurbanov  
 Finance and Accounting Manager

7 March 2011




The notes set out on pages 9 to 35 are an integral part of these financial statements.

**FINCA Azerbaijan LLC**  
**Statement of Changes in Equity for the Year Ended 31 December 2010**  
*in thousands of United States Dollars, unless otherwise indicated*

	Share capital	Retained earnings	Total equity
Balance as at 1 January 2009	5	12,052	12,057
Comprehensive income for 2009	-	3,145	3,145
<b>Balance as at 31 December 2009</b>	<b>5</b>	<b>15,197</b>	<b>15,202</b>
Comprehensive income for the 2010	-	3,703	3,703
<b>Balance as at 31 December 2010</b>	<b>5</b>	<b>18,900</b>	<b>18,905</b>

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 Manish Sane  
 Chief Executive Officer



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 Elshan Gurbanov  
 Finance and Accounting Manager



7 March 2011



## **1. Principal Activities of the Company**

FINCA Azerbaijan Non-Bank Credit Organization LLC (“the Company” or “FINCA”) provides financial facilities to small entrepreneurs in various regions of Azerbaijan so that they can create jobs, build assets and improve their standard of living.

The Company was established in April 1998 and started its lending operations in June 1998. Until 19 November 1999 it was registered as a representative office of FINCA in Azerbaijan. On 19 November, 1999, the Company was registered with the Azerbaijan Ministry of Justice and obtained the status of a legal entity. The Company was reregistered to comply with the regulations of the Central Bank of Azerbaijan, in accordance with which only legal entities can perform lending activities on the territory of Azerbaijan. The new entity obtained a license for lending activities from the Central Bank of Azerbaijan on 29 February 2000.

FINCA principally provides small loans to individuals and to groups of individuals that lack access to traditional financial institutions.

The Company is a subsidiary of FINCA International LLC, which has a registered office in Maryland, United States of America.

The ultimate controlling party of the Company is FINCA International, Inc., a not-for-profit corporation, incorporated in New York, United States of America, that has received a determination letter from the United States Internal Revenue Service classifying it as a tax-exempt public charity described in Section 501(c)(3) of the United States Internal Revenue Code of 1986, as amended. Its affiliates are typically separate legal entities operating under affiliation agreements with FINCA International, Inc.

The principal location of the Company’s office is at 44, Jafar Jabbarly Street, Baku AZ1065, Azerbaijan. The Company has branches and offices in the most of regions of Azerbaijan.

The average number of the Company’s employees in 2010 was 766 (2009: 714).

## **2. Operating Environment of the Company**

### **General**

Over recent years, Azerbaijan has undergone substantial political and economic changes. As an emerging market, Azerbaijan does not possess a well-developed commercial infrastructure, which generally exists in more mature business markets. Laws and regulations affecting businesses operating within the country are subject to rapid change. In addition, continued economic stability is dependent to a large extent on the effectiveness of fiscal and monetary measures taken by the government, regulatory developments, decisions of international lending organizations, and other actions beyond the Company’s control.

Although recently there have been positive economic signs in Azerbaijan, the long-term prospects for the Azerbaijani economy remain uncertain. National economy is dependent of export of hydrocarbon resources. As a result, the Company’s assets and operations could be at risk resulting from any adverse changes in the political and business environment.

### **Financial market transactions**

The global financial crisis has resulted in, among other things, global liquidity crunch which led to contraction of the international and domestic capital market, lower liquidity levels across the Azerbaijani banking sector and very high uncertainty in the domestic and foreign equity markets. The uncertainties in the global financial market have also led to bank failures and bank rescues in the United States of America, Western Europe, Russia and other countries, however its impact on financial system of Azerbaijan was has been relatively limited. Currently, it is impossible to fully assess the influence of the ongoing crisis or avoid its impact.

Since 2008 investors have been re-evaluating their exposure to risks, which resulted in reduced or closed limits on transactions conducted in Azerbaijan, thereby adding to volatility. Such circumstances can affect the ability of the Company to obtain new borrowings at terms and conditions similar to those applied to earlier transactions.

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

**Inflation**

In 2010 inflation in Azerbaijan was significant, although less than in previous years. The official inflation indices for the last three years are given in the table below:

<b>Year ended</b>	<b>Inflation for the period</b>
31 December 2010	5.7%
31 December 2009	1.5%
31 December 2008	20.8%

**Currency transactions**

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

<b>Date</b>	<b>AZN 1</b>	<b>EUR 1</b>
31 December 2010	1.2533	0.9470
31 December 2009	1.2452	0.8696

**3. Basis of Presentation**

**General principles**

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

**Functional and presentation currency**

These financial statements are presented in USD being the Company's functional and presentation currency. USD is the currency, in which majority of funds from financing activities are generated and in which majority of receipts from operating activities are retained.

**Estimates and assumptions**

The preparation of the financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as at the date of the financial statements preparation, and the reported amounts of revenues and expenses during the reporting period. Issues that require best estimate and are most significant for the financial statements are disclosed in Notes 4, 7, 9, 10.

**Going concern**

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

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

To maintain the required liquidity level the Company can attract additional funds from external lending market. Diversification of liquidity sources allows to minimise the Company's dependence on any source and ensure full satisfaction of its liabilities. A sufficient current liquidity cushion accumulated by the Company and the available sources of additional fund-raising allow the Company to continue its operations as a going concern on a long-term basis.

**Effect of changes in the presentation format**

**Reclassification**

Previously the Company showed current and non-current items in the statement of financial position separately. In 2010 the Company changed such format to the presentation based on decreasing order of liquidity as providing information that is reliable and more relevant for a lending institution.

The following changes have been made by the Company in the corresponding figures of the statement of financial position as at 31 December 2009 to conform to the 2010 presentation format:

<b>Item</b>	<b>Previously reported</b>	<b>Reclas-sified</b>	<b>Amount of reclas-sification</b>	<b>Comments</b>
<b>Assets</b>				
Loans to customers	65,853	67,184	1,331	Reclassification of interest receivable from 'Other receivables' to 'Loans to customers'
Other receivables	3,573	-	(3,573)	Reclassification of 'Other receivables' to 'Other receivables, prepaid expenses and other assets'
Prepaid and other assets	360	-	(360)	Reclassification of 'Prepaid and other assets' to 'Other receivables, prepaid expenses and other assets'
Short-term investments	1,500	-	(1,500)	Reclassification of 'Short-term investments' to 'Other receivables, prepaid expenses and other assets'
Other receivables, prepaid expenses and other assets	-	3,590	3,590	Reclassification of 'Other receivables' and 'Prepaid and other assets' to 'Other receivables, prepaid expenses and other assets'
Current income tax assets	-	403	403	Separation of current tax assets from other receivables
Deferred tax assets	1,619	570	(1,049)	Offsetting deferred tax assets and liabilities
<b>Total</b>			<b>(1,158)</b>	
<b>Liabilities</b>				
Interest payable	1,121	-	(1,121)	Reclassification of interest payable to notes payable and subordinated debt
Subordinated debt	-	7,080	7,080	Separation of subordinated debt and its interest from Notes payable
Notes payable	66,714	60,646	(6,068)	Reclassification of deferred commission costs from other receivables to notes payable
Deferred tax liabilities	1,049	-	(1,049)	Offsetting deferred tax assets and liabilities
<b>Total</b>			<b>(1,158)</b>	

The data for the year 2009 in the statement of cash flows were adjusted to reflect the corrections in the comparative information for the year 2009 in the statement of financial position.

**Prior year errors**

In 2010 the Company corrected its treatment of capitalization of cost of acquisition of intangible assets for income tax purposes and retrospectively changed its provision for taxes as at 31 December 2009. The amount of decrease of current tax asset was USD 256 thousand and increase in deferred tax assets was USD 234 thousand, and amount of total tax charge increased by USD 24 thousand as compared with amounts reported in the financial statements for the year ended 31 December 2009 approved for issue on 11 March 2010.

### **Changes in Accounting Policies**

The accounting policies adopted are generally consistent with those of the previous financial year. The Company has changed its internal loan loss provision methodology since 1 January 2010. The new methodology utilizes migration analysis of loan losses during last two years (Note 7).

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

- IAS 1 "Presentation of Financial Statements" (effective for annual periods beginning on or after 1 January 2010). The main amendment is the change in classification of the liability component of a convertible instrument as current or non-current.
- IAS 7 "Statement of Cash Flows" (effective for annual periods beginning on or after 1 January 2010). The revised Standard (paragraph 16) requires that only expenditures that result in a recognized asset can be classified as a cash flow from investing activities.
- IAS 17 "Leases" (effective for annual periods beginning on or after 1 January 2010). The classification of the land and building elements as finance or operating lease should be made separately for each element and should follow the general lease classification guidance. For classification of land all factors provided for other lease contracts should be considered.
- IAS 36 "Impairment of Assets" (effective for annual periods beginning on or after 1 January 2010). According to the revised Standard, each cash-generating unit or group of units to which goodwill is allocated shall not be larger than an operating segment before aggregation.
- IAS 39 "Financial Instruments: Recognition and Measurement" (effective for annual periods beginning on or after 1 January 2010). The key areas of amendments included treatment of loan prepayment penalties as closely related embedded derivatives, scope exemption for business combination contracts and cash flow hedge accounting.
- IFRS 3 "Business Combinations" (effective for annual reporting periods beginning on or after 1 July 2009). The main amendments clarify measurement of goodwill and non-controlling interest.
- IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" (effective for annual periods beginning on or after 1 January 2010). The scope of IFRS 5 has been clarified to make it clear that only the disclosures specified in IFRS 5 are applicable to non-current assets (or disposal groups) classified as held for sale, and to discontinued operations.
- IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments" (effective for annual periods beginning on or after 1 July 2010). This IFRIC provides guidance on treating settlement of a financial liability through the issue of an entity's own equity to the creditor.

### **IFRSs and IFRIC interpretations not yet effective**

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

- Amendments to IFRS 1 "Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters" (effective for annual periods beginning on or after 1 July 2010).
- Amendments to IFRS 7 "Disclosures - Transfers of Financial Assets" (effective for annual periods beginning on or after 1 July 2011). These Amendments increase the disclosure requirements for transactions involving transfers of financial assets.
- IFRS 9 (as amended in 2010) "Financial Instruments" (effective for annual periods beginning on or after 1 January 2013). This Standard issued in November 2009 and amended in October 2010 introduces new requirements for the classification and measurement of financial assets and financial liabilities and for derecognition.
- IAS 24 (revised in 2009) "Related Party Disclosures" (effective for annual periods beginning on or after 1 January 2011). This revised Standard modifies the definition of a related party and simplifies disclosures for government-related entities.
- Amendments to IAS 32 "Classification of Rights Issues" (effective for annual periods beginning on or after 1 February 2010). The Amendments address the classification of certain rights issues denominated in a foreign currency as either an equity instrument or as a financial liability.
- IFRIC 13 "Customer Loyalty Programs" (effective for annual periods beginning on or after 1 January 2011). This IFRIC addresses measurement of award credits by reference to fair value.

- IFRIC 14 “The Limit on a Defined Benefit Asset(s), Minimum Funding Requirements and their Interaction” (effective for annual periods beginning on or after 1 January 2011). The main amendments address treatment of prepayments of minimum contributions.

The Management anticipates that IFRS 9 will be adopted in the Company's financial statements for the annual period beginning 1 January 2013 and that the application of the new Standard will have a significant impact on amounts reported in respect of the Company' financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of that effect until a detailed review has been completed.

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

#### **4. Summary of Significant Accounting Policies**

##### ***Cash and cash equivalents***

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

##### ***Financial assets***

The Company classifies its financial assets in the following categories:

- loans and receivables (this category includes loans to customers and receivables);
- financial assets available for sale.

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

##### ***Initial recognition of financial instruments***

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

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

##### ***Fair value measurement***

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

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

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

##### ***Derecognition of financial assets***

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

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

Where the Company has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Company's continuing involvement in the asset. Continuing involvement that takes

the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Company could be required to repay.

#### **Loans to customers**

This category includes non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;
- those that the entity upon initial recognition designates as available for sale;
- those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.

Loans to customers are initially recorded at cost, which is the fair value of the consideration given. Subsequently, they are carried at amortized cost using the effective interest method less provision for loan impairment.

Loans to customers are recorded when cash is advanced to borrowers.

Loans to customers originated at interest rates different from market rates are remeasured at origination to their fair values, being future interest payments and principal repayment(s) discounted at market interest rates for similar loans. The difference between the fair value and the nominal value at origination is credited or charged to the statement of comprehensive income as gains /losses on origination of assets at rates above/below market. Subsequently, the carrying amount of such loans is adjusted for amortization and the related gains/losses are recorded within the statement of comprehensive income using the effective interest method.

#### **Impairment of financial assets**

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

#### **Impairment of loans to customers**

For loans to customers carried at amortized cost, the Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant or collectively for financial assets that are not individually significant.

Objective evidence that loans to customers are impaired includes observable data about the following events in respect of individually significant financial assets:

- default in any payments due;
- significant financial difficulty of the borrower supported by financial information at the Company's disposal;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganization;
- worsening national or local economic environment affecting the borrower;
- breach of contract, such as a default or delinquency in interest or principal payments;
- the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider.

Assets that are individually assessed for impairment and for which an impairment loss is recognized are not included in a collective assessment of impairment.

If the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics such as asset type, industry, geographical location, collateral type, payment status and other relevant factors. The characteristics chosen are relevant to the estimation of future cash flows for groups of such assets by being indicative of the borrowers' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

The main criterion used for determining objective evidence of loss from impairment of due from other banks and loans to customers representing collectively measured financial assets is availability of observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group.

Such information may include adverse changes in the payment status of borrowers in the group (for example, an increased number of delayed payments or an increased number of credit card borrowers who have reached their credit limit and are paying the minimum monthly amount), national or local economic conditions that correlate with defaults on the assets in the group (for example, an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices for mortgages in the relevant area, a decrease in oil prices for loan assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group).

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced through the use of the provision account and the amount of the loss is recognized in the statement of comprehensive income.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

Loans that have not been individually assessed are then included in the group of loans that are collectively assessed for impairment. The collectively assessed loans are grouped based on similar credit risk characteristics and on their past-due status and assessed accordingly. The collectively assessment methodology strives to ensure the provision for impairment reflects the loss events that have occurred, but have not yet been identified on an individual loan basis.

The process uses a combination of historical data and current observable data that reflect the existing situation and how it may affect the current loan portfolio. Historical data used is a set of actual loss rates calculated using the historical loan loss migration analysis. Existing economic data includes actual rates. Using these data sets as inputs, the management then determines the new set of rates to be used for the next 6 month period.

Future cash flows in a group of loans that are collectively evaluated for impairment are estimated on the basis of historical loss experience for loans with credit risk characteristics similar to those in the group or on the basis of historical information on collections of past due debts. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect and are directionally consistent with changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

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

Loans overdue for more than 6 months are written off against the related allowance for impairment after all the necessary procedures to recover the asset in full or in part have been completed and the final amount of the loss has been determined. The carrying value of impaired financial assets is not reduced directly.

In case of a write-off of the uncollectible loan and relating interest, the Company shall take necessary and adequate steps, envisaged by law, custom of business turnover or agreement, to collect this outstanding loan.

### **Financial liabilities**

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

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

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

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

***Financial liabilities carried at amortized cost***

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

***Offsetting of financial instruments***

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

***Property and equipment***

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

At each reporting date the Company assesses whether there is any indication of impairment of property and equipment. If such indication exists, the Company estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. Where the carrying amount of property and equipment is greater than their estimated recoverable amount, it is written down to their recoverable amount and the difference is charged as impairment loss to the statement of comprehensive income.

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

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

***Depreciation***

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

- Furniture - 5 years;
- Computers and office equipment - 3 years;
- Motor vehicles - 5 years.

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

***Intangible assets acquired separately***

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

***Operating lease - the Company as a lessee***

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

***Charter capital***

Statutory charter capital is recorded at its nominal amount actually paid in in accordance with the Company's constitution documents.

***Dividends***

The policy the Company is reinvesting all retained earnings in increasing operations. No dividends are declared or distributed.

***Contingent assets and liabilities***

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

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

#### **Taxation**

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

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

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

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

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

#### **Income and expense recognition**

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

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

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

#### **Employee benefits and social insurance contributions**

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

#### **Foreign currency**

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

effect at the transaction date. Non-monetary items denominated in foreign currency and carried at fair value are restated at the exchange rate in effect at the date the fair value is determined.

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

#### **5. Critical accounting estimates and judgments**

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

##### ***Provision for impairment of loans to customers***

The specific counterparty component of the total allowances for impairment applies to claims evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgments about counterparty's financial situation and the net realizable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function.

Collectively assessed impairment allowances cover credit losses inherent in portfolios of claims with similar economic characteristics when there is objective evidence to suggest that they contain impaired claims, but the individual impaired items cannot yet be identified. A component of collectively assessed allowances is for country risks. In assessing the need for collective loan credit loss allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, assumptions are made to define the way inherent losses are modeled and to determine the required input parameters, based on historical experience and current economic conditions. The accuracy of the allowances depends on how well these estimated future cash flows for specific counterparty allowances are forecast and the model assumptions and parameters used in determining collective allowances.

##### ***Fair value of financial instruments***

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

##### ***Useful lives of property and equipment***

As described in the Note 4 above, the Company reviews the estimated useful lives of property, plant and equipment at the end of each reporting period.

##### ***Legal proceedings***

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

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

##### ***Income taxes***

The Company is subject to income tax and significant judgment is required in determining the provision for income taxes. During the ordinary course of business, there are transactions and calculations for which the ultimate tax determination is uncertain. As a result, the company recognizes tax liabilities based on estimates of whether additional taxes and interest will be due. These tax liabilities are recognized when, despite the company's belief that its tax return positions are supportable, the company believes that certain positions are likely to be challenged and may not be fully sustained upon review by tax authorities. The company believes that its accruals

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for tax liabilities are adequate for all open audit years based on its assessment of many factors including past experience and interpretations of tax law. This assessment relies on estimates and assumptions and may involve a series of complex judgments about future events. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact income tax expense in the period in which such determination is made.

**6. Cash and Cash Equivalents**

	2010	2009
Cash on hand	41	438
Cash balances with banks	7,289	10,114
<b>Total cash and cash equivalents</b>	<b>7,330</b>	<b>10,552</b>

**7. Loans to Customers**

	2010	2009	2008
Gross loans to customers	84,147	69,235	66,850
Interest receivable	1,540	1,330	998
Repayments pending allocation	(665)	(740)	-
Deferred commission fees	(2,466)	(1,686)	(1,397)
Provision for impairment of loans to customers	(549)	(955)	(708)
<b>Loans to customers, net</b>	<b>82,007</b>	<b>67,184</b>	<b>65,743</b>

Deferred commission fees represent unamortized part of upfront fees received on loans' origination.

Movements in the provision for impairment of loans to customers during 2010 and 2009 are as follows:

	Total
<b>Provision for impairment of loans to customers as at 1 January 2009</b>	<b>708</b>
Provision for impairment during 2009	511
Recovery of bad debts	99
Loans written off during 2009 as uncollectible	(363)
<b>Provision for impairment of loans to customers as at 31 December 2009</b>	<b>955</b>
Provision for impairment during 2010	54
Recovery of bad debts	187
Loans written off during 2010 as uncollectible	(647)
<b>Provision for impairment of loans to customers as at 31 December 2010</b>	<b>549</b>

Included in loans written off during 2010 as uncollectible are loans granted to inhabitants of central regions of Azerbaijan, which suffered from flood. Amount of these write-offs totaled USD 133 thousand.

Economic sector concentrations within the Company's loan portfolio are as follows:

	2010		2009	
	Amount	%	Amount	%
Agriculture	39,908	47	31,206	46
Trade	21,289	25	12,765	18
Services	9,050	11	5,100	7
Manufacturing	1,410	2	899	1
Other	12,490	15	19,265	28
<b>Total loans to customers (gross)</b>	<b>84,147</b>	<b>100</b>	<b>69,235</b>	<b>100</b>

The Company does not have any separate borrower with the total amount exceeding 1% of total gross loan portfolio.

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Below is the credit quality analysis of loans collectively assessed for impairment as at 31 December 2010:

	Loans before impairment provision	Impairment provision	Loans less impairment provision	Ratio of impairment provision to total loans before impairment provision
Loans not past due	83,768	502	83,266	0.60%
Less than 1 month overdue	174	9	165	5.17%
1 to 3 months overdue	81	8	73	9.88%
3 to 6 months overdue	124	30	94	24.19%
Repayments pending allocation	(665)	-	(665)	-
Deferred commission fees	(2,466)	-	(2,466)	-
Interest receivable	1,540	-	1,540	-
<b>Total loans</b>	<b>82,556</b>	<b>549</b>	<b>82,007</b>	<b>0.67%</b>

Below is the credit quality analysis of loans collectively assessed for impairment as at 31 December 2009:

	Loans before impairment provision	Impairment provision	Loans less impairment provision	Ratio of impairment provision to total loans before impairment provision
Loans not past due	68,649	687	67,962	1.00%
Less than 1 month overdue	184	15	169	8.15%
1 to 3 months overdue	168	63	105	37.50%
3 to 6 months overdue	235	190	45	80.85%
Repayments pending allocation	(740)	-	(740)	-
Deferred commission fees	(1,687)	-	(1,687)	-
Interest receivable	1,330	-	1,330	-
<b>Total loans</b>	<b>68,139</b>	<b>955</b>	<b>67,184</b>	<b>1.40%</b>

As at 31 December 2010, accrued interest income on impaired loans to customers amounted to USD 1 thousand (2009: USD 2 thousand).

Loans not past due represent loans issued to borrowers with high level of liquidity and profitability. Collectively impaired loans include loans grouped in homogeneous pools of claims sharing common characteristics in respect of risk exposure and collectively assessed by the Company.

Below is the information on the collateral held as security as at 31 December 2010:

	2010	2009
Equipment	7,498	2,740
Households	6,177	23,646
Motor vehicles	3,693	2,395
Real estate	3,458	3,894
Gold	1,507	1,083
Livestock	681	200
Goods for sale	8	11
<b>Total collateral</b>	<b>23,022</b>	<b>33,969</b>

As at 31 December 2010, loans to customers in the total amount of USD 65,864 thousand or 80 % of total loans to customers are not secured (2009: USD 48,114 thousand or 72 % of total loans to customers).

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Below is the information on the collateral held as security for individually impaired loans as at 31 December 2010:

	2010	2009
Households	81	228
Cash deposits	59	-
Real estate	56	64
Gold	16	4
Equipment	5	-
Livestock	3	-
Motor vehicles	-	30
<b>Total collateral for impaired loans</b>	<b>220</b>	<b>326</b>

The collateral value of the security may differ from its fair value.

**8. Other receivables, prepaid expenses and other assets**

	2010	2009
Prepaid rent	230	191
Accrued interest on cash balances with banks	174	71
Staff advances and loans	82	343
Prepaid taxes (other than income taxes)	62	51
Overpaid interest expense (MEF)	18	-
Prepaid insurance	8	9
Prepaid advertisement	4	1
Receivable from affiliates for FLEXCUBE	-	975
Receivable from FINCA International, Inc.	-	387
Short-term deposit	-	1,500
Other receivables	-	62
<b>Total other receivables, prepaid expenses and other assets</b>	<b>578</b>	<b>3,590</b>

Short-term deposit of USD 1,500 thousand in 2009 represents temporary investment of idle cash funds in interest bearing bank accounts.

**9. Property and Equipment**

	Leasehold improvements	Furniture, computers and office equipment	Motor vehicles	Construction in progress	Total
<b>Net book value as at 31 December 2009</b>	-	804	77	12	893
<b>Cost</b>					
Balance as at 1 January 2010	17	1,392	151	12	1,572
Additions	-	378	1	24	403
Disposals	-	(19)	-	(2)	(21)
<b>Balance as at 31 December 2010</b>	<b>17</b>	<b>1,751</b>	<b>152</b>	<b>34</b>	<b>1,954</b>
<b>Accumulated depreciation</b>					
Balance as at 1 January 2010	17	588	74	-	679
Depreciation charge	-	331	28	-	359
<b>Balance as at 31 December 2010</b>	<b>17</b>	<b>919</b>	<b>102</b>	<b>-</b>	<b>1,038</b>
<b>Net book value as at 31 December 2010</b>	<b>-</b>	<b>832</b>	<b>50</b>	<b>34</b>	<b>916</b>

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	Leasehold improvements	Furniture, computers and office equipment	Motor vehicles	Construction in progress	Total
<b>Net book value as at 1 January 2009</b>	-	560	107	65	732
<b>Cost</b>					
Balance as at 1 January 2009	17	905	151	65	1,138
Additions	-	487	-	-	487
Disposals	-	-	-	(53)	(53)
<b>Balance as at 31 December 2009</b>	<b>17</b>	<b>1,392</b>	<b>151</b>	<b>12</b>	<b>1,572</b>
<b>Accumulated depreciation</b>					
Balance as at 1 January 2009	17	345	44	-	406
Depreciation charge	-	243	30	-	273
<b>Balance as at 31 December 2009</b>	<b>17</b>	<b>588</b>	<b>74</b>	<b>-</b>	<b>679</b>
<b>Net book value as at 31 December 2009</b>	<b>-</b>	<b>804</b>	<b>77</b>	<b>12</b>	<b>893</b>

Construction in progress represents assets which have been acquired but are not readily available for use. As soon as this work is completed the assets are recorded within the appropriate category of property and equipment.

**10. Intangible assets**

	Capitalized Software
<b>Net book value as at 31 December 2009</b>	<b>3,769</b>
<b>Cost</b>	
Balance at 1 January 2010	4,154
Acquisitions	319
<b>Balance at 31 December 2010</b>	<b>4,473</b>
<b>Accumulated amortization</b>	
Balance at 1 January 2010	385
Amortization for the period	894
<b>Balance at 31 December 2010</b>	<b>1,279</b>
<b>Net book value as at 31 December 2010</b>	<b>3,194</b>

	Capitalized Software	Capital Work-In-Progress	Total
<b>Net book value as at 1 January 2009</b>	43	2,142	2,185
<b>Cost</b>			
Balance at 1 January 2009	125	2,142	2,267
Acquisitions	4,029	(2,142)	1,887
<b>Balance at 31 December 2009</b>	<b>4,154</b>	<b>-</b>	<b>4,154</b>
<b>Accumulated amortization</b>			
Balance at 1 January 2009	82	-	82
Amortization for the period	303	-	303
<b>Balance at 31 December 2009</b>	<b>385</b>	<b>-</b>	<b>385</b>
<b>Net book value as at 31 December 2009</b>	<b>3,769</b>	<b>-</b>	<b>3,769</b>

Intangible assets are mainly represented by management and accounting information system (FlexCube).

**11. Income taxes**

Income tax expense comprises the following:

	2010	2009	2008
Current income tax expense	1,394	916	1,044
Deferred taxation movement due to origination and reversal of temporary differences	72	182	(488)
Effect of change in income tax rate	-	(17)	-
<b>Total income tax expense for the year</b>	<b>1,466</b>	<b>1,081</b>	<b>556</b>

The current tax rate applicable to the Company's profit is 20% (2009: 22%).

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

	2010	2009
Operating profit before taxation	6,589	4,226
Theoretical tax charge at the applicable statutory rate 20% (2009: 22%)	1,318	930
Non-deductible expenses less non-taxable income	148	151
<b>Income tax expense for the year</b>	<b>1,466</b>	<b>1,081</b>

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

	2010			2009		
	Assets	Liabilities	Net asset/ (liability)	Assets	Liabilities	Net asset/ (liability)
Property and equipment, and software	-	43	(43)	-	323	(323)
Other receivables and other assets	-	64	(64)	-	439	(439)
Payables and accruals	474	-	474	997	-	997
Loans to customers	509	-	509	569	-	569
<b>Net tax assets / (liabilities)</b>	<b>983</b>	<b>107</b>	<b>876</b>	<b>1,566</b>	<b>762</b>	<b>804</b>

	2009			2008		
	Assets	Liabilities	Net asset/ (liability)	Assets	Liabilities	Net asset/ (liability)
Property and equipment, and	-	323	(323)	-	232	(232)
Other receivables and other assets	-	439	(439)	-	216	(216)
Payables and accruals	997	-	997	954	-	954
Loans to customers	569	-	569	463	-	463
<b>Net tax assets / (liabilities)</b>	<b>1,566</b>	<b>762</b>	<b>804</b>	<b>1,417</b>	<b>448</b>	<b>969</b>

Net deferred tax assets represent the amounts of income tax that may be offset against future income taxes and are reported as deferred tax assets in the statement of financial position.

Provisions of tax legislation of Azerbaijan often are subject to varying interpretations by tax payers and tax authorities. The management aims to apply requirements of law prudently and conservatively to minimise risk of any penalties. Recently the management revised some of its tax accounting policies; in particular those related to determination of tax base of intangible assets and application of withholding taxes and their treatment for current profits tax purposes. The state tax inspection is planned to commence in April and will cover tax reporting periods from 2008 to 2010. Management also has undertaken an exercise, which is expected to be completed before the tax inspection, to update the active agreements in order to bring them in condition that will reduce the risk of any sanctions by tax authorities resulting from ambiguity of documentation.

**12. Notes payable**

	2010	2009	2008
<i>External notes payable</i>			
Principal amount	61,359	52,744	48,175
Accrued interest	785	972	861
Deferred fees	(61)	(40)	-
<b>Total External notes payable:</b>	<b>62,083</b>	<b>53,676</b>	<b>49,036</b>
<i>Intercompany notes payable</i>			
Principal amount	3,983	6,970	9,290
<b>Total Internal notes payable:</b>	<b>3,983</b>	<b>6,970</b>	<b>9,290</b>
<b>Total notes payable</b>	<b>66,066</b>	<b>60,646</b>	<b>58,326</b>

Deferred commission fees represent unamortized part of upfront fees paid on loans' origination.

External notes payable have the following maturities:

Year	2010	2009
2010	-	18,231
2011	22,381	22,363
2012	17,011	8,000
2013	21,967	4,150
<b>Total</b>	<b>61,359</b>	<b>52,744</b>

Intercompany notes payable have the following maturities:

Year	2010	2009
2010	-	2,320
2011	1,987	2,320
2012	1,996	2,330
<b>Total</b>	<b>3,983</b>	<b>6,970</b>

**13. Subordinated debt**

	2010	2009
<i>External subordinated debt</i>		
Principal amount	7,000	7,000
Accrued interest	139	149
Deferred fees	(58)	(69)
<b>Total external subordinated debt</b>	<b>7,081</b>	<b>7,080</b>

In November 2009 the Company borrowed USD 7,000 thousand from FINCA Microfinance Fund managed by Deutsche Bank as Fund manager under an umbrella facility of USD 21,000 thousand for other FINCA affiliates countries as subordinated debt, which is payable after the senior obligations are pari pasu fully paid off. This subordinated debt has a maturity in November 2016 as a lumpsum payment. The interest rate on the subordinated debt is fixed at 12.54% p.a. net of withholding taxes (2009: 12.54%).

**14. Other liabilities**

	2010	2009
Accruals	730	722
Payroll and other personnel expenses	394	2,935
Donations	323	-
Tax liability (other than profit tax) and other budget liabilities	302	110
Affiliation fee	107	34
Payable for intangible assets	-	210
<b>Total other liabilities</b>	<b>1,856</b>	<b>4,011</b>

**15. Share capital**

Authorized share capital of the Company is USD 5 thousand and has not changed since 1999.

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16. Interest and similar income and expense	2010	2009
<b>Interest income</b>		
Loans to customers	30,915	27,643
Cash balances with banks	189	72
<b>Total interest income</b>	<b>31,104</b>	<b>27,715</b>
<b>Interest expense</b>		
Notes payable	5,606	6,093
Subordinated debt	989	167
<b>Total interest expense</b>	<b>6,595</b>	<b>6,260</b>
<b>Net interest income</b>	<b>24,509</b>	<b>21,455</b>
17. Personnel expenses	2010	2009
Wages and salaries	6,654	6,495
Compulsory social security obligations	1,905	1,692
Employees health insurance	121	103
Allowances, incentives and other benefits	2,287	1,985
<b>Total personnel expenses</b>	<b>10,967</b>	<b>10,275</b>
18. General and administrative expenses	2010	2009
Rent expenses	1,289	1,189
Affiliation fees	992	766
Bank charges	851	712
Communication	650	451
Security	412	376
IT professional fees	343	16
Travelling	333	318
Consumables and office supply	235	296
Marketing	92	96
Audit fees	89	80
Repair and maintenance	83	168
Utilities	62	52
Training and hiring	51	43
Motor vehicles expenses	49	24
Insurance	37	19
Other professional fee	27	16
Legal professional fees	22	18
Meeting and conferences	10	3
<b>Total operating expenses</b>	<b>5,627</b>	<b>4,643</b>

## **19. Other operating expenses**

Other operating expenses in 2009 include USD 674 thousand of withholding taxes and value-added taxes, which have not been allocated to respective expense categories, USD 206 thousand of provision for cash misappropriated by an employee and USD 139 thousand of miscellaneous expenses.

## **20. Donations made**

On 27 July 2010 the Company signed an agreement with Avrasiya Credit, a national microfinance institution. This agreement specifies the terms and conditions of granting an aggregate amount of USD 1,420 thousand by FINCA to Avrasiya Credit for financing its microloans. Through this agreement the Company assured the stakeholders including Government of Azerbaijan in its commitment to the sustainable development of the microfinance sector in Azerbaijan.

Avrasiya Credit is obligated to use grant funds for the authorized purposes, as indicated in the Agreement, namely for poverty alleviation of clients based upon merit, need and ability to repay. The Company is committed to transfer funds in 8 quarterly installments of USD 136,875 totaling to USD 1,095 thousand and remaining USD 325 thousand will be utilized to pay for the services of monitoring, auditing and technical assistance.

FINCA's main focus through agreement is to make grant in order to:

- i) fund an increase in the loan capital of Avrasiya that will be used to make additional microfinance loans in Azerbaijan;
- ii) fund capacity building services; and
- iii) pay for monitoring, auditing and technical assistance on a regular basis.

A separate agreement for monitoring of this grant was signed between FINCA and the Azerbaijan Micro-finance Association (AMFA) on 24 December 2010. AMFA has been entrusted to conduct monitoring of implementation of the grant of USD 1,420 thousand and its social impact extended by FINCA to Avrasiya. Under this agreement FINCA shall pay to AMFA USD 100 thousand over a period of 5 years for service and AMFA will provide the following services:

- i) Baseline and report on social impact, initially and on annual basis until the end of the project; and
- ii) Conducting financial monitoring and monitoring of portfolio of Avrasiya and reporting to FINCA on target implementation of the grant agreement and action plan on a quarterly basis as per the structure agreed by FINCA.

## **21. Risk Management**

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

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

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

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed by obtaining property and securities collateral and corporate and personal guarantees.

The Company's maximum exposure to credit risk is primarily reflected in the carrying value of financial assets in the statement of financial position. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant. For commitments to extend credits, the maximum exposure to credit risk is equal to total liabilities (Note 22).

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrument failing to perform in accordance with the terms of the contract. The

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Company uses the same credit policies in making contingent obligations as it does for on-balance sheet financial instruments through established credit approvals, risk control limits and monitoring procedure.

The Company performs the loan maturity analysis and subsequent monitoring of overdue balances. Therefore, the management provides data on overdue maturities and other information on credit risk, as described in Note 7.

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

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

**Geographical risk.** The geographical concentration of the Company's assets and liabilities as at 31 December 2010 is set out below:

	Azerbaijan	OECD	Total
<b>Assets</b>			
Cash and cash equivalents	7,330	-	7,330
Loans to customers	82,007	-	82,007
Other receivables, prepaid expenses and other assets	578	-	578
Property and equipment	881	35	916
Intangible Assets	3,194	-	3,194
Deferred income tax assets	876	-	876
<b>Total assets</b>	<b>94,866</b>	<b>35</b>	<b>94,901</b>
<b>Liabilities</b>			
Notes Payable	-	66,066	66,066
Subordinated Debt	-	7,081	7,081
Other liabilities	1,856	-	1,856
Current tax liabilities	993	-	993
<b>Total liabilities</b>	<b>2,849</b>	<b>73,147</b>	<b>75,996</b>
<b>Net balance sheet position</b>	<b>92,017</b>	<b>(73,112)</b>	<b>18,905</b>
Credit related commitments	653	-	653

The geographical analysis of the Company's assets and liabilities as at 31 December 2009 is set out below:

	Azerbaijan	OECD	Total
<b>Assets</b>			
Cash and cash equivalents	10,552	-	10,552
Loans to customers	67,184	-	67,184
Other receivables, prepaid expenses and other assets	3,590	-	3,590
Property and equipment	893	-	893
Intangible assets	3,769	-	3,769
Current income tax asset	147	-	147
Deferred income tax assets	804	-	804
<b>Total assets</b>	<b>86,939</b>	<b>-</b>	<b>86,939</b>
<b>Liabilities</b>			
Notes Payable	-	60,646	60,646
Subordinated Debt	-	7,080	7,080
Other liabilities	4,011	-	4,011
<b>Total liabilities</b>	<b>4,011</b>	<b>67,726</b>	<b>71,737</b>
<b>Net balance sheet position</b>	<b>82,928</b>	<b>(67,726)</b>	<b>15,202</b>
Credit related commitments	3,318	-	3,318

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**Currency risk.** The Company takes on exposure to effects of fluctuations in the foreign currency exchange rates on its financial position and cash flows. The Asset and Liability Management Committee sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily.

The table below summarizes the Company's exposure to foreign currency exchange rate risk as at 31 December 2010.

	AZN	USD	EUR	Total
<b>Assets</b>				
Cash and cash equivalents	1,190	6,134	6	7,330
Loans to customers	22,178	59,829	-	82,007
Other receivables, prepaid expenses and other	578	-	-	578
Property and equipment	916	-	-	916
Intangible assets	3,194	-	-	3,194
Deferred income tax assets	876	-	-	876
<b>Total assets</b>	<b>28,932</b>	<b>65,963</b>	<b>6</b>	<b>94,901</b>
<b>Liabilities</b>				
Notes payable	11,571	54,495	-	66,066
Subordinated debt	-	7,081	-	7,081
Other liabilities	1,583	273	-	1,856
Current tax liabilities	993	-	-	993
<b>Total liabilities</b>	<b>14,147</b>	<b>61,849</b>	<b>-</b>	<b>75,996</b>
<b>Net balance sheet position</b>	<b>14,785</b>	<b>4,114</b>	<b>6</b>	<b>18,905</b>
Credit related commitments	-	653	-	653

As at 31 December 2009, the Company had the following positions in currencies:

	AZN	USD	Total
<b>Assets</b>			
Cash and cash equivalents	3,322	7,230	10,552
Loans to customers	12,996	54,188	67,184
Other receivables, prepaid expenses and other assets	944	2,646	3,590
Property and equipment	893	-	893
Intangible assets	3,769	-	3,769
Current income tax asset	147	-	147
Deferred income tax assets	804	-	804
<b>Total assets</b>	<b>22,875</b>	<b>64,064</b>	<b>86,939</b>
<b>Liabilities</b>			
Notes payable	6,210	54,436	60,646
Subordinated debt	-	7,080	7,080
Other liabilities	3,509	502	4,011
<b>Total liabilities</b>	<b>9,719</b>	<b>62,018</b>	<b>71,737</b>
<b>Net balance sheet position</b>	<b>13,156</b>	<b>2,046</b>	<b>15,202</b>
Credit related commitments	-	3,318	3,318

The Company issued loans and bears expenses in currencies other than its functional currency. Depending on the revenue stream of the borrower, the appreciation of the currencies against the USD may adversely affect the borrowers' repayment ability and therefore increases the likelihood of future loan losses.

The table below shows the change in the financial result and comprehensive income due to possible fluctuations of exchange rates used as at the reporting date if all other conditions remain unchanged. Reasonably expected exchange rate changes for each currency were projected on the basis of maximal exchange rate fluctuations in December 2010.

	2010	
	Effect on profit or loss before taxation	Effect on comprehensive income
AZN appreciation by 6%	277	222
AZN depreciation by 6%	(277)	(222)

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The table below shows the change in the financial result and comprehensive income due to possible fluctuations of exchange rates used as at 31 December 2009 if all other conditions remain unchanged. Reasonably expected exchange rate changes for each currency were projected on the basis of maximal exchange rate fluctuations in December 2009.

	Effect on profit or loss before taxation	2009 Effect on comprehensive income
AZN appreciation by 6%	123	98
AZN depreciation by 6%	(123)	(98)

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

**Liquidity risk.** Liquidity risk is defined as the risk when the maturity of assets and liabilities does not match. The Company is exposed to risk via daily calls from customers on its available cash resources from customer accounts, maturing deposits, loan draw downs, guarantees and cash-settled derivative financial instruments. The Company does not accumulate cash resources to meet calls on all liabilities mentioned above, as based on the existing practice, it is possible to forecast with a sufficient degree of certainty the required level of cash funds necessary to meet the above obligations. Liquidity risk is managed by the Treasury Department with regard for decisions of the Company's Standing Conference for decision making in asset formation and transaction funding requirements (the Conference).

The Company is keen on maintaining stable financing predominantly consisting of due to other banks, deposits of legal entities/deposits of individuals, debt securities and also on investing funds in diversified liquid asset portfolios to be able to meet unexpected liquidity needs quickly and unhampered.

To manage its liquidity, the Company is required to analyze the level of liquid assets needed to settle the liabilities on their maturity by providing access to various sources of financing, drawing up plans to solve the problems with financing and exercising control over compliance of the liquidity ratios with the laws and regulations.

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

The Management regularly monitors the liquidity position and performs periodic liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions.

The table below shows the liabilities as at 31 December 2010 by their remaining contractual maturity. The amounts in the table represent contractual undiscounted cash flows. These undiscounted cash flows differ from the amounts recorded in the statement of financial position which are based on discounted cash flows.

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

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The table below shows the maturity analysis of financial liabilities as at 31 December 2010:

	On demand and less than 1	From 1 to 6 months	From 6 to 12 months	From 1 to 5 years	More than 5 years	Total
<b>Liabilities</b>						
Notes payable	1,494	16,800	10,014	44,996	-	73,304
Subordinated debt	-	441	449	3,562	7,892	12,344
Current income tax liabilities	-	993	-	-	-	993
Other liabilities	57	1,140	161	498	-	1,856
<b>Total potential future payments under financial liabilities</b>	<b>1,551</b>	<b>19,374</b>	<b>10,624</b>	<b>49,056</b>	<b>7,892</b>	<b>88,497</b>

The table below shows the maturity analysis of financial liabilities as at 31 December 2009:

	On demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 1 to 5 years	More than 5 years	Total
<b>Liabilities</b>						
Notes payable	390	10,308	15,089	42,672	-	68,459
Subordinated debt	-	441	449	3,562	8,782	13,234
Other liabilities	185	3,433	-	393	-	4,011
<b>Total potential future payments under financial liabilities</b>	<b>575</b>	<b>14,182</b>	<b>15,538</b>	<b>46,627</b>	<b>8,782</b>	<b>85,704</b>

The Company does not use the above undiscounted amounts in the maturity analysis to monitor the liquidity profile. Instead, the Company monitors the expected maturity limits presented in the table below as at 31 December 2010:

	On demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 1 to 5 years	More than 5 years	Total
<b>Assets</b>						
Cash and cash equivalents	7,330	-	-	-	-	7,330
Loans to customers	9,794	40,961	27,309	3,943	-	82,007
Other receivables, prepaid expenses and other assets	196	382	-	-	-	578
Property and equipment	-	-	-	916	-	916
Intangible assets	-	-	-	3,194	-	3,194
Deferred income tax assets	-	-	-	876	-	876
<b>Total assets</b>	<b>17,320</b>	<b>41,343</b>	<b>27,309</b>	<b>8,929</b>	<b>-</b>	<b>94,901</b>
<b>Liabilities</b>						
Notes payable	1,243	15,465	8,399	40,959	-	66,066
Subordinated debt	-	135	-	-	6,946	7,081
Current tax liabilities	-	993	-	-	-	993
Other liabilities	57	1,140	161	498	-	1,856
<b>Total liabilities</b>	<b>1,300</b>	<b>17,733</b>	<b>8,560</b>	<b>41,457</b>	<b>6,946</b>	<b>75,996</b>
<b>Net liquidity gap as at 31 December 2010</b>	<b>16,020</b>	<b>23,610</b>	<b>18,749</b>	<b>(32,528)</b>	<b>(6,946)</b>	<b>18,905</b>
<b>Cumulative liquidity gap as at 31 December 2010</b>	<b>16,020</b>	<b>39,630</b>	<b>58,379</b>	<b>25,851</b>	<b>18,905</b>	

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The table below shows the expected maturity analysis as at 31 December 2009:

	On demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 1 to 5 years	More than 5 years	Total
<b>Assets</b>						
Cash and cash equivalents	10,552	-	-	-	-	10,552
Loans to customers	7,991	36,003	17,981	5,209	-	67,184
Other receivables, prepaid expenses and other assets	1,096	946	1,446	102	-	3,590
Property and equipment	-	-	-	893	-	893
Intangible assets	-	-	-	3,769	-	3,769
Current income tax assets	-	147	-	-	-	147
Deferred income tax assets	-	-	-	804	-	804
<b>Total assets</b>	<b>19,639</b>	<b>37,096</b>	<b>19,427</b>	<b>10,777</b>	<b>-</b>	<b>86,939</b>
<b>Liabilities</b>						
Notes payable	388	8,631	12,481	39,146	-	60,646
Subordinated debt	-	146	-	-	6,934	7,080
Other liabilities	185	3,433	-	393	-	4,011
<b>Total liabilities</b>	<b>573</b>	<b>12,210</b>	<b>12,481</b>	<b>39,539</b>	<b>6,934</b>	<b>71,737</b>
<b>Net liquidity gap as at 31 December 2009</b>	<b>19,066</b>	<b>24,886</b>	<b>6,946</b>	<b>(28,762)</b>	<b>(6,934)</b>	<b>15,202</b>
<b>Cumulative liquidity gap as at 31 December 2009</b>	<b>19,066</b>	<b>43,952</b>	<b>50,898</b>	<b>22,136</b>	<b>15,202</b>	

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

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

The Company is exposed to interest rate risk, principally as a result of lending at fixed interest rates, in amounts and for periods, which differ from those of term borrowings at fixed interest rates. In practice, interest rates are generally fixed on a short-term basis. Also, interest rates fixed contractually on both assets and liabilities are usually renegotiated to reflect current market conditions.

The Management sets limits on the level of mismatch of interest rate re-pricing that may be undertaken, which is monitored regularly. In the absence of any available hedging instruments, the Company normally seeks to match its interest rate positions.

The table below summarises the Company's exposure to interest rate risks as at 31 December 2010. Included in the table are the Company's financial assets and liabilities at carrying amounts, categorized by the earlier of contractual re-pricing or maturity dates.

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	On demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 1 to 5 years	More than 5 years	Non- interest bearing	Total
<b>Assets</b>							
Cash and cash equivalents	7,289	-	-	-	-	41	7,330
Loans to customers	9,795	40,960	27,309	3,943	-	-	82,007
Other receivables, prepaid expenses and other assets	-	-	-	-	-	578	578
Property and equipment	-	-	-	-	-	916	916
Intangible assets	-	-	-	-	-	3,194	3,194
Deferred income tax assets	-	-	-	-	-	876	876
<b>Total assets</b>	<b>17,084</b>	<b>40,960</b>	<b>27,309</b>	<b>3,943</b>	<b>-</b>	<b>5,605</b>	<b>94,901</b>
<b>Liabilities</b>							
Notes payable	1,243	19,015	4,848	40,960	-	-	66,066
Subordinated debt	-	135	-	-	6,946	-	7,081
Current tax liabilities	-	993	-	-	-	-	993
Other liabilities	-	-	-	-	-	1,856	1,856
<b>Total liabilities</b>	<b>1,243</b>	<b>20,143</b>	<b>4,848</b>	<b>40,960</b>	<b>6,946</b>	<b>1,856</b>	<b>75,996</b>
<b>Net interest rate gap as at 31 December 2010</b>	<b>15,841</b>	<b>20,817</b>	<b>22,461</b>	<b>(37,017)</b>	<b>(6,946)</b>	<b>3,749</b>	<b>18,905</b>
<b>Cumulative interest rate gap as at 31 December 2010</b>	<b>15,841</b>	<b>36,658</b>	<b>59,119</b>	<b>22,102</b>	<b>15,156</b>	<b>18,905</b>	

The table below summarizes the Company's exposure to interest rate risks as at 31 December 2009.

	On demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 1 to 5 years	More than 5 years	Non- interest bearing	Total
<b>Assets</b>							
Cash and cash equivalents	10,114	-	-	-	-	438	10,552
Loans to customers	7,991	36,003	17,981	5,209	-	-	67,184
Other receivables, prepaid expenses and other assets	18	1,589	107	103	-	1,773	3,590
Property and equipment	-	-	-	-	-	893	893
Intangible assets	-	-	-	-	-	3,769	3,769
Current income tax assets	-	-	-	-	-	147	147
Deferred income tax assets	-	-	-	-	-	804	804
<b>Total assets</b>	<b>18,123</b>	<b>37,592</b>	<b>18,088</b>	<b>5,312</b>	<b>-</b>	<b>7,824</b>	<b>86,939</b>
<b>Liabilities</b>							
Notes payable	336	4,684	16,480	39,146	-	-	60,646
Subordinated debt	-	146	-	-	6,934	-	7,080
Other liabilities	-	-	-	-	-	4,011	4,011
<b>Total liabilities</b>	<b>336</b>	<b>4,830</b>	<b>16,480</b>	<b>39,146</b>	<b>6,934</b>	<b>4,011</b>	<b>71,737</b>
<b>Net interest rate gap as at 31 December 2009</b>	<b>17,787</b>	<b>32,762</b>	<b>1,608</b>	<b>(33,834)</b>	<b>(6,934)</b>	<b>3,813</b>	<b>15,202</b>
<b>Cumulative interest rate gap as at 31 December 2009</b>	<b>17,787</b>	<b>50,549</b>	<b>52,157</b>	<b>18,323</b>	<b>11,389</b>	<b>15,202</b>	

If as at 31 December 2010 the interest rates had been by 50 basis points lower, provided all other conditions remained unchanged, the profit would have been by USD 282 thousand (2009: by USD 274 thousand) higher as a result of the decreased interest expenses on other floating rate borrowings.

If as at 31 December 2010 the interest rates had been by 50 basis points higher, provided all other conditions remained unchanged, the profit would have been by USD 282 thousand (2009: by USD 274 thousand) lower as a result of the increased interest expenses on other floating rate borrowings.

**FINCA Azerbaijan LLC**  
**Notes to the Financial Statements for the Year Ended 31 December 2010 (continued)**  
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The Company monitors financial instrument interest rates. The table below shows the interest rates on the basis of reports that were analyzed by the Company's key managers as at 31 December 2010 and 2009:

	2010		2009	
	AZN	USD	AZN	USD
<b>Assets</b>				
Loans to customers	36-43%	27-45.6%	33-39%	30-42%
Other receivables, prepaid expenses and other assets	-	-	-	8-13.5%
<b>Liabilities</b>				
Notes payable	10.5-12.5%	4.75%+Libor - 13%	11%	8.5-13%
Subordinated debt	-	12.54%	-	12.54%

The "-" sign in the table above means that the Company does not have respective assets or liabilities in the corresponding currency.

## 22. Capital Management

Currently no capital requirements have been established by the Central Bank of the Azerbaijan Republic for non-bank credit organization. Management's focus in respect of the Company's capital management has the following objectives: ensuring the Company's ability to operate as a going concern and maintain balances in order to comply with Covenants of Lenders & Investors. This is exercised daily in respect of the projected and actual data and on the basis of monthly reports with the corresponding calculations that are verified and signed by the Chairman of the Board and Chief Accountant of the Company.

## 23. Contingent Liabilities

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

**Tax legislation.** As disclosed in Note 11 above Azerbaijani tax legislation is subject to varying interpretations and changes which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Company may be challenged by the relevant regional or federal authorities. Recent events in Azerbaijan have shown that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the tax authorities in respect of taxes for three calendar years preceding the year of the review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2010, the management believes that its interpretation of the relevant legislation is appropriate and the Company's tax, currency and customs positions will be sustained by controlling bodies.

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

**Credit related commitments.** The main objective of these instruments is to provide funds to customers when necessary. The total outstanding contractual amount undrawn credit lines does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded. With respect to credit risk on undrawn credit lines, the Company is less exposed to the risk of loss since in the case of impairment of loans issued the Company will not pay the remaining amounts. Therefore, no provision for these credit related commitments is created.

Outstanding credit related commitments of the Company are as follows:

	2010	2009
Undrawn credit lines	653	3,318
<b>Total credit related commitments</b>	<b>653</b>	<b>3,318</b>

## 24. Fair Value of Financial Instruments

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

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

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

**Loans to customers.** Loans to customers are reported net of impairment provisions. The estimated fair value of loans to customers represents the discounted amount of estimated future cash flows expected to be received. To determine fair value, expected cash flows are discounted at current market rates. The management believes that the fair values of loans to customers as at 31 December 2010 and 31 December 2009 do not materially differ from respective carrying amounts. This is primarily due to the existing practice to renegotiate interest rates to reflect current market conditions. So, interest on most balances is accrued at rates approximating market interest rates.

**Borrowings.** The fair value of fixed interest bearing financial liabilities carried at amortized cost is determined by comparing the market interest rates at initial recognition of these instruments with current market rates on similar financial instruments. The estimated fair value of fixed interest bearing securities is based on discounted cash flows using interest rates for debt instruments with similar credit risk and maturity. The fair value of debt securities actively traded on an exchange is based on their market quotations.

The fair value of variable rate borrowings without market quotations is based on discounted cash flows using interest rates for debt instruments with similar maturity. The estimated fair value of other borrowed funds approximates their carrying value as these instruments do not have market quotations and are attracted at floating interest rate.

## 25. Related Party Transactions

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

In the normal course of business the Company enters into transactions with its major shareholders, directors, subsidiaries and other related parties. These transactions include settlements, issuance of loans, deposit taking, guarantees, trade finance and foreign currency transactions. According to the Company's policy the terms of related party transactions are equivalent to those that prevail in arm's length transactions.

The outstanding balances at the year end and asset transactions with related parties for 2010 are as follows:

	FINCA International, Inc.	FINCA Capital Fund	Key management personnel	Total
<b>Balances</b>				
Other liabilities	107	-	-	107
Notes payable	-	3,983	-	3,983
<b>Transactions</b>				
Interest expense	-	613	-	613
Loans issued	-	2,987	-	2,987
Non-interest income	795	-	-	795
Non-interest expense	1,288	-	265	1,553

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The outstanding balances at the year end and asset transactions with related parties for 2009 are as follows:

	FINCA International, Inc.	FINCA Capital Fund	Key management personnel	Total
<b>Balances</b>				
Other receivables, prepaid expenses and other assets	387	-	-	387
Notes payable	-	6,970	-	6,970
<b>Transactions</b>				
Interest expense	-	907	-	907
Loans issued	500	2,320	-	2,820
Interest income	12	-	-	12
Non-interest expense	1,464	-	698	2,162

In 2010 the remuneration to members of the Company's Management Board amounted to USD 265 thousand (2009: USD 698 thousand). The members of Supervisory Board of the Company are full-time employees of FINCA International, Inc. and they serve not only on the Company's board, but also on boards of its affiliates. FINCA International, Inc. manages many shared services for the whole network, e.g. seeking grants & donations, public relations, investor relationship, etc. Supervisory Board's member's remuneration is not apportioned to any affiliate company.