

FINCA AZERBAIJAN

**Financial Statements for the
Years Ended 31 August 2003 and 2002,
and Independent Auditors' Report**

FINCA AZERBAIJAN

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Deloitte & Touche
2 Gertsena Street
Minsk 220030
Belarus

Tel.: +375 17 211 03 29
Tel.: +375 17 211 03 92
Fax: +375 17 211 03 44
www.deloitte.by

**Deloitte
& Touche**

INDEPENDENT AUDITORS' REPORT

To the Founders of FINCA Azerbaijan and FINCA International Inc.:

We have audited the accompanying statements of financial position of FINCA Azerbaijan (the "Organization") as of 31 August 2003 and 2002, and the related statements of activities, functional expenses and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of FINCA Azerbaijan as of 31 August 2003 and 2002, and the results of its activities and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche

24 October 2003

Deloitte
Touche
Tohmatsu

FINCA AZERBAIJAN**STATEMENTS OF FINANCIAL POSITION
AS AT 31 AUGUST 2003 AND 2002
(in US Dollars)**

	Notes	2003	2002
ASSETS			
CURRENT ASSETS:			
Unrestricted cash	3	363,158	609,912
Restricted cash	3	56,320	118,334
Cash and cash equivalents		<u>419,478</u>	<u>728,246</u>
Investments with FINCA Inc.	4	120,260	342,485
Loans to customers, net	5	1,007,387	446,036
Grant support due	4	131,164	-
Prepaid expenses and other assets	7	<u>18,159</u>	<u>23,693</u>
Total current assets		<u>1,696,448</u>	<u>1,540,460</u>
NON-CURRENT ASSETS:			
Long-term note, FINCA Inc.	4	-	60,000
Property, plant and equipment, net	8	<u>34,659</u>	<u>19,001</u>
Total non-current assets		<u>34,659</u>	<u>79,001</u>
TOTAL ASSETS		<u>1,731,107</u>	<u>1,619,461</u>
LIABILITIES AND NET ASSETS			
CURRENT LIABILITIES:			
Accrued expenses and other payables	9	44,850	187,284
Unearned grant support	4	-	184,856
Short-term loan	10	<u>235,945</u>	<u>-</u>
Total current liabilities		<u>280,795</u>	<u>372,140</u>
LONG TERM LOAN		<u>-</u>	<u>118,334</u>
TOTAL LIABILITIES		<u>280,795</u>	<u>490,474</u>
NET ASSETS:			
Unrestricted		<u>1,450,312</u>	<u>1,128,987</u>
Total net assets		<u>1,450,312</u>	<u>1,128,987</u>
TOTAL LIABILITIES AND NET ASSETS		<u>1,731,107</u>	<u>1,619,461</u>

The notes on pages 6 to 13 form an integral part of these financial statements. Independent Auditors' Report is on page 1.

FINCA AZERBAIJAN

STATEMENTS OF ACTIVITIES FOR THE YEARS ENDED 31 AUGUST 2003 AND 2002 (in US Dollars)

	Notes	2003	2002
CHANGES IN UNRESTRICTED NET ASSETS:			
REVENUES:			
Grants	4	495,368	188,946
Interest income		529,287	275,979
Other income		49,956	25,339
Total revenues		<u>1,074,611</u>	<u>490,264</u>
NET ASSETS RELEASED FROM RESTRICTIONS:			
Satisfaction of program restrictions	4	<u>85,931</u>	<u>602,274</u>
Total net assets released from restrictions		85,931	602,274
EXPENSES:			
Program services (direct)		(150,150)	(85,370)
General and administrative (indirect)		<u>(689,067)</u>	<u>(427,344)</u>
Total expenses		<u>(839,217)</u>	<u>(512,714)</u>
Increase in unrestricted net assets		<u>321,325</u>	<u>579,824</u>
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS:			
Contributions	4	85,931	602,274
Net assets released from restrictions:			
Satisfaction of program restrictions	4	<u>(85,931)</u>	<u>(602,274)</u>
Change in temporarily restricted net assets		<u>-</u>	<u>-</u>
CHANGE IN NET ASSETS		321,325	579,824
NET ASSETS, BEGINNING OF YEAR		<u>1,128,987</u>	<u>549,163</u>
NET ASSETS, END OF YEAR		<u>1,450,312</u>	<u>1,128,987</u>

The notes on pages 6 to 13 form an integral part of these financial statements. Independent Auditors' Report is on page 1.

FINCA AZERBAIJAN

STATEMENTS OF FUNCTIONAL EXPENSES FOR THE YEARS ENDED 31 AUGUST 2003 AND 2002 (in US Dollars)

	Notes	2003	2002
DIRECT:			
Loan officers' salaries		59,165	54,054
Employee benefits		81,498	29,144
Provision for loan losses	6	9,487	2,172
Total direct expenses		150,150	85,370
INDIRECT:			
Administrative salaries		154,113	112,673
Payroll taxes	12	(27,919)	36,982
Rent		79,108	62,569
Maintenance		3,250	5,123
Professional services		53,680	9,715
Office supplies		26,186	19,684
Depreciation		13,179	8,540
Travel and per diem		51,124	40,000
Meetings and conferences		9,633	6,442
Forex loss		5,187	15,420
Communications		20,609	13,010
Training		4,022	5,258
Bank charges		29,530	5,691
Other taxes		7,532	26
Miscellaneous		25,059	12,066
Other non-operating expense		51	1,210
Administrative services fees to FINCA HUB	4	5,398	10,454
Management fees to FINCA Inc.	4	154,493	43,424
Affiliation fees to FINCA Inc.	4	74,832	19,057
Total indirect expenses		689,067	427,344
TOTAL EXPENSES		839,217	512,714

The notes on pages 6 to 13 form an integral part of these financial statement Independent Auditors' Report is on page 1.

FINCA AZERBAIJAN

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED 31 AUGUST 2003 AND 2002 (in US Dollars)

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	321,325	579,824
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation expense	13,179	8,540
Provision for loan losses	9,487	2,172
Increase in loans	(570,838)	(204,454)
Increase in grant support due	(131,164)	-
Decrease / (increase) in prepaid expenses and other assets	5,534	(14,460)
(Decrease) / increase in accrued expenses and other payables	(142,434)	66,827
(Decrease)/ increase in unearned grant support	(184,856)	128,778
Loss on disposal of property, plant and equipment	47	486
	<u>(679,720)</u>	<u>567,713</u>
Net cash (used in)/ provided by operating activities		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Decrease/ (increase) in investment into note/advance, FINCA Inc.	282,225	(335,407)
Purchases of property, plant and equipment	(28,884)	(11,391)
	<u>253,341</u>	<u>(346,798)</u>
Cash flows provided by/ (used in) investing activities		
CASH FLOWS FROM FINANCING ACTIVITIES:		
Receipt of long-term loan	-	118,334
Receipt of short-term loan	117,611	-
	<u>117,611</u>	<u>118,334</u>
Cash flows provided by financing activities		
NET (DECREASE) / INCREASE IN CASH AND CASH EQUIVALENTS	(308,768)	339,249
CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR	<u>728,246</u>	<u>388,997</u>
CASH AND CASH EQUIVALENTS, END OF THE YEAR	<u><u>419,478</u></u>	<u><u>728,246</u></u>

The notes on pages 6 to 13 form an integral part of these financial statements. Independent Auditors' Report is on page 1.

FINCA AZERBAIJAN

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEARS ENDED 31 AUGUST 2003 AND 2002 (in US Dollars)

1. BACKGROUND

FINCA International Inc. ("FINCA Inc."), a not-for-profit organization, is incorporated in the USA. The purpose of FINCA Inc. is to 'Help the poor help themselves'. FINCA Inc. believes that world hunger and poverty cannot be cured simply by food handouts and grants but can be permanently affected by self-help and self-sufficiency of the poor.

FINCA Inc. provides self-help opportunity by establishing community revolving loan funds, or "village banks", in impoverished communities through affiliated organizations ("affiliates"). The affiliates are separate legal entities with separate boards of directors that enter into affiliate agreements with FINCA Inc. Small loans support investment in individual or community productive micro enterprises. Through management by the poor themselves and increasing borrower savings, participants build self-reliance, self-esteem, and a savings fund that remains within the community as a permanent source of capital for continued investment.

FINCA Azerbaijan ("the Organization") is an affiliate of FINCA Inc. Through its regional hub headquartered in Moscow, Russia ("FINCA HUB"), FINCA Inc. carries out Small Enterprise Technical Assistance and Financing Programs in the Trans-Caucasus region. FINCA Azerbaijan is responsible for the Republic of Azerbaijan.

The Organization's mission is to support the economic and human development of Azeri families trapped in severe poverty. This is to be accomplished through the creation of Savings and Credit Groups – associations of several individual members who receive the following services: working capital loans to finance self-employment activities and a mutual support system that encourages self-worth and personal development.

The Organization was established in April 1998 and started its operations in June 1998. Until 25 November 2000 it was registered as a representative office of FINCA Inc. in Azerbaijan ("the representative office"). Starting from the aforementioned date, the Organization was re-registered and obtained the status of legal entity.

The Organization was re-registered to comply with the regulation of the National Bank of Azerbaijan, in accordance with which only legal entities can perform lending activities on the territory of Azerbaijan. The new entity has obtained a license for lending activity from the National Bank of Azerbaijan on 9 November 2000.

Although the representative office has not been closed, virtually all its assets and liabilities have been transferred to the newly formed legal entity. The financial statements presented herein include the financial position and results of operations of both the representative office and legal entity.

FINCA AZERBAIJAN

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEARS ENDED 31 AUGUST 2003 AND 2002 (in US Dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting – The financial statements have been prepared, in all material respects, in accordance with accounting principles that are generally accepted in the United States of America (“US GAAP”) under the historical cost convention.

Use of Estimates – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Grants and Grant Support – Under the Co-operative Agreements for United States Agency for International Development (“USAID”) projects and the Grant Agreement with BTC Co. and BP Exploration Limited for Pipeline Micro-finance initiative FINCA Inc. advances the Organization funds based on short-term liquidity needs. The Organization records each advance as unearned grant support. When an allowable expenditure is made, the corresponding amount is removed from unearned grant support and recognized as grant revenue.

Cash and Cash Equivalents – Cash and cash equivalents include instruments with an original maturity, when purchased, of less than three months.

Loans to Customers – Loans are stated at the outstanding principal balance of loans less specific and general provisions for loan losses. The Organization estimates amounts of possible losses on loans at the statement of financial position date to determine the provisions.

The Organization has determined specific provision for possible loan losses against large loans on a case-by-case basis. Specific provisions are assessed with reference to the credit standing and performance of the borrower and take into account the value of any collateral or third party guarantees. The Organization also maintains a general provision against the loan portfolio as a whole.

Property, Plant and Equipment – Property, plant and equipment is carried at cost less accumulated depreciation. Depreciation begins in the month following the month of purchase and is calculated using the straight-line method over the following estimated useful lives:

Leasehold improvements	Term of lease
Computer equipment and software	3 years
Office furniture	5 years
Office equipment	5 years

When assets are retired, or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the statement of activities. The cost of maintenance and repairs is charged to the statement of activities as incurred. Significant renewals and betterments that extend the assets’ estimated useful lives are capitalized.

Grant Contributions Unrestricted and Temporarily Restricted – The Organization receives unrestricted contributions from USAID, BTC Co. and BP Exploration Limited to cover its operating expenditures and recognizes these contributions as revenue as the related expenditures are incurred.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEARS ENDED 31 AUGUST 2003 AND 2002 (in US Dollars)

The Organization also receives temporarily restricted contributions from USAID to lend those funds to its customers. The funds remain temporarily restricted until all the following conditions are satisfied: (a) funds are lent to the customer which are eligible for the USAID grant participation; (b) funds are received back (loan is redeemed) by the customer in full. Upon the satisfaction of the above conditions, the funds are considered to be released from temporary restrictions and are recognized as a part of net increase in unrestricted net assets in Statement of Activities.

Revenues and Expenses Recognition – Interest income and expenses are recognized on an accrual basis. Non-interest expenses are recognized at the time when the transaction occurs.

Translation of Foreign Currency – The US dollar (USD) is the reporting currency. The books and records of the Organization are maintained in USD, although a significant volume of operations, i.e. loan granting and repayments, receipt of interest, payment of operating expenses, are done in Azeri Manat (AZM).

The translation of the results of transactions denominated in AZM is made in accordance with SFAS 52 "Foreign Currency Translation". Exchange rates used are official rates of the National Bank of Azerbaijan, which approximate the market rates. The monthly average USD/AZM exchange rates are used for translation of revenues and expenses, historical USD/AZM exchange rates are used for translation of the purchased non-monetary assets and period end rates are used for translation of monetary assets and liabilities outstanding at the period end. Gains and losses originated on such translation are included in the statement of activities.

The exchange rates as of 31 August 2003 and 2002 were 4,913 and 4,898 AZM/USD, respectively.

The translation of AZM-denominated assets and liabilities into USD as at 31 August 2003 and 2002 does not indicate that the Organization could realize, or settle in USD, the translated value of these assets and liabilities.

Change in manner of presenting of comparative figures – the Statements of Functional Expenses and the Statements of Cash Flows were expanded to disclose more detailed information to the users of the Organization's financial statements.

3. CASH AND CASH EQUIVALENTS

	2003	2002
Cash in hand	29,547	304,322
Cash in bank	333,611	240,184
Cash in transit	-	65,406
Total unrestricted cash	363,158	609,912
Restricted cash in bank	56,320	118,334
Cash and cash equivalents	<u>419,478</u>	<u>728,246</u>

Restricted cash represent cash received by the Organization under loan agreement with Social Fund for Internally Displaced Persons. See also Note 10. Under this agreement, cash should be used only for the purposes determined under the provision of the agreement.

FINCA AZERBAIJAN

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEARS ENDED 31 AUGUST 2003 AND 2002 (in US Dollars)

4. RELATED PARTY TRANSACTIONS

The related parties of the Organization include key management of the Organization, FINCA Inc. and other companies of FINCA Inc. group (i.e. FINCA HUB and all affiliates) as discussed in Note 1.

During 2003 and 2002 the Organization received grant support from USAID through FINCA Inc. The revenue derived from this grant support received to cover the current expenditures was USD 335,874 and USD 188,946 for 2003 and 2002, respectively. During 2003 and 2002 the Organization received temporarily restricted contributions from USAID to lend those funds to its customers in the amount USD 85,931 and USD 602,274, respectively. All those contributions were released from the temporary restrictions and recognized as revenue during 2003 and 2002. During 2003 the Organization incurred USD 17,543 of current expenditures to be subsequently covered by grant support from BTC Co. and BP Exploration Limited through FINCA Inc. The amount of current expenditures was recognized as revenue from grant support in 2003.

During 2003 and 2002 the Organization received administrative services from FINCA Inc. The amount of such services was USD 154,493 and USD 43,424 for 2003 and 2002, respectively. USD 104,825 of management fee charged by FINCA Inc. during 2003 was recognized by the Organization as revenue from grant support. The amount of affiliation fee remains partially unpaid as of 31 August 2003 and 2002 (see Note 9).

During 2003 FINCA Inc. paid USD 37,126 of current expenses on behalf of the Organization. The respective amount was recognized as expense and revenue from grant support on the financial statements of the Organization.

Grants support due from FINCA Inc. was USD 131,164 as of 31 August 2003. Unearned grant support was USD 184,856 as of 31 August 2002.

The Organization has a 0.87 % demand advance receivable from FINCA Inc. of USD 120,260 and a 6.5% demand advance receivable from FINCA Inc. of USD 342,485 as of 31 August 2003 and 2002, respectively. The Organization had a long-term 6.5% note receivable from FINCA Inc. of USD 60,000 as of 31 August 2002, which was redeemed in March 2003. The major reason for the Organization to buy the note and make advances is to transfer funds of the Organization from unstable economy conditions and reduce cash related risks.

During 2003 and 2002 the Organization received administrative services from FINCA Inc. through FINCA HUB. The amount of such services was USD 5,398 and USD 10,454 for 2003 and 2002 respectively, which remains partially unpaid as of 31 August 2002 (see Note 9).

FINCA Inc. charges the Organization 1 % affiliation fee of monthly loan disbursements. Starting from December 2002 FINCA Inc. began charging the Organization 2% affiliation fee of loans disbursed during the month. The affiliation fee charged by FINCA Inc. was USD 74,832 and USD 19,057 in 2003 and 2002, respectively, which remains partially unpaid as of 31 August 2003 and 2002 (see Note 9).

FINCA AZERBAIJAN

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEARS ENDED 31 AUGUST 2003 AND 2002 (in US Dollars)

5. LOANS TO CUSTOMERS, NET

Loans to customers are granted within Azerbaijan both in local currency and USD. Loans outstanding as at 31 August 2003 and 2002 were granted to groups of small entrepreneurs and to individuals. Loans are short-term. Depending on the type of loan principal and interest amounts are paid weekly, bi-weekly or monthly by equal installments.

	2003	2002
Loans to customers	1,030,300	455,139
Provision for loan losses (Note 6)	<u>(22,913)</u>	<u>(9,103)</u>
Loans to customers, net	<u>1,007,387</u>	<u>446,036</u>

The maturity analysis of the loans is as follows:

	2003	2002
Due less than one month	67,781	29,252
Due within 1-3 months	385,294	254,151
Due within 3-6 months	483,627	171,736
Due within 6-12 months	<u>93,598</u>	<u>-</u>
Loans to customers	<u>1,030,300</u>	<u>455,139</u>

6. PROVISION FOR LOAN LOSSES

The movements in the provision for loans and advances to customers are as follows:

31 August 2001	<u>24,444</u>
Additional provision	2,172
Write off against provision	<u>(17,513)</u>
31 August 2002	<u>9,103</u>
Additional provision	9,487
Recovery of written-off amounts	<u>4,323</u>
31 August 2003	<u>22,913</u>

The provision for loans and advances to customers is deducted from the related asset.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEARS ENDED 31 AUGUST 2003 AND 2002 (in US Dollars)

7. PREPAID EXPENSES AND OTHER ASSETS

	2003	2002
Accrued interest on loans	10,736	7,033
Prepaid rent	4,151	16,228
Other assets	3,272	432
	<u>18,159</u>	<u>23,693</u>

8. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consisted of the following of 31 August 2003 and 2002:

	2003	2002
Leasehold improvements	2,687	2,687
Computer equipment and software	49,288	22,041
Office furniture	4,046	3,846
Office equipment	9,970	9,148
	<u>65,991</u>	<u>37,722</u>
Less: Accumulated depreciation	<u>(31,332)</u>	<u>(18,721)</u>
Property, plant and equipment, net	<u>34,659</u>	<u>19,001</u>

9. ACCRUED EXPENSES AND OTHER PAYABLES

	2003	2002
Accrued expenses payable to FINCA Inc. (Note 4)	7,972	-
Accrued affiliation fee payable to FINCA Inc. (Note 4)	37	32,785
Admin fee payable to FINCA Inc. (Note 4)	5,075	43,424
Accrued hub fee payable to FINCA HUB (Note 4)	-	19,122
Payroll accrual	15,766	13,339
Provision for personal income tax and other social contributions accrued on salaries of employees	-	78,614
Audit fee payable	16,000	-
	<u>44,850</u>	<u>187,284</u>

10. SHORT TERM LOAN

On 10 May 2002 the Organization entered into loan agreement with the Social Fund for Internally Displaced Persons. Under this loan agreement the Organization is to obtain maximum of USD 295,835 of an interest-free loan for the period of up to two years. The funds received should be used specifically for the purpose of disbursement micro-loans to the customers, not less than 80% of whom should be refugees (called "internally displaced persons"). As of 31 August 2003 and 2002 the Organization received USD 235,945 and USD 118,334, respectively, under this loan, USD 179,625 of which was disbursed during 2003.

FINCA AZERBAIJAN

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEARS ENDED 31 AUGUST 2003 AND 2002 (in US Dollars)

11. INCOME TAX

The Organization did not have taxable profits in 2003. As of 31 August 2003 the Organization did not have any significant temporary differences between the carrying and tax values of its assets and liabilities, and, therefore, there are no material deferred tax assets and liabilities as of that date.

12. PAYROLL TAXES

The credit on payroll taxes in 2003 is due to the change in the accounting estimate of the provision related to payroll taxes.

13. COMMITMENTS AND CONTINGENCIES

Operating Environment – Over recent years, Azerbaijan has undergone substantial political and economic change. 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, as well as throughout the CIS, are subject to rapid change. In addition, continued economic stability is dependent to a large extent on the efficacy of fiscal measures taken by the government, decisions of international lending organizations, and other actions beyond the Organization's control.

Although recently there have been positive economic signs in Azerbaijan, including lower inflation and a slower rate of devaluation of the Manat, the long-term prospects for the Azeri economy remain uncertain. As a result, the Organization's assets and operations could be at risk if there are any adverse changes in the political and business environment.

Taxation and other statutory regulations – In accordance with the Agreement between the Government of the United States of America and the Government of the Republic of Azerbaijan Regarding Cooperation to Facilitate the Provision of Assistance signed on 11 May 2000 the Organization is defined as an operator responsible for implementation of U.S. Government assistance programs and is not liable for income tax, value added tax or any other taxes derived from any activities related to grants with the only exception for social and pension contributions paid for the local employees to the State pension fund.

Azeri tax authorities are increasingly directing their attention to the business community as a result of the overall economic environment. In respect of this, the local and national tax environment in Azerbaijan is constantly changing and subject to inconsistent application, interpretation and enforcement. Non-compliance with Azeri laws and regulations can lead to the imposition of severe penalties and interest. Future tax examinations could include taxes, penalties and interest, and these amounts could be material. While the Organization believes it has complied with local tax legislation, there have been many new tax and foreign currency laws and related regulations introduced in recent years, which are not always clearly written or applied consistently.

The Organization believes it has complied with all applicable regulations and requirements. However, since the regulations are not always clearly written, it is difficult to predict future interpretations by regulatory authorities, and outcomes of such interpretations.

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**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED 31 AUGUST 2003 AND 2002
(in US Dollars)**

The management of the Organization considers the probability of any sanctions being undertaken by local authorities against the Organization remote, and believes that no fines or penalties will become payable.

14. PENSIONS AND RETIREMENT PLANS

The employees of the Organization received benefits from the Azeri government in accordance with the laws and regulations of Azerbaijan. At 31 August 2003 and 2002, the Organization was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.