

ЕШВ СЦТЫГДЕШТП

Auditor's conclusion

To: "CredAgro" Board of Directors

- 1. We audited the balance sheet of "CredAgro", non-banking credit organization (hereafter referred to as "the Company") as of December 31, 2004 and related reports on profit/loss, cash flow and flow of capital funds for the audited period. The management of the company is responsible for preparation of financial statements. We are responsible for the expression of our opinion about stated financial statements based on the conducted audit.*
- 2. The audit was implemented in accordance with commonly accepted auditing standards. These standards require that we conduct the planned audit in order to obtain a reasonable level of confidence whether there is any essential inaccuracy in the financial statements. Audit includes analysis based on sampling of data confirming the accuracy of reflected figures in the financial statements. Audit also includes the evaluation of applied accounting principles and forecasts made by the administration of the Company, which is considered as an evaluation of financial reporting as a whole. We feel the audit as conducted by us is sufficient to form an opinion.*
- 3. An audit of accounting balance of the Company as of December 31, 2003 and related reports on profit/loss for the same period was implemented by TID Consulting who submitted report on those financial statements on May 17, 2004.*
- 4. International standard of accounting № 1 – "Presentation of financial statements" requires that financial statements reflect respective figures for the previous period. A comment on the auditor's report for December 31, 2003, related accounting balance and report on profit/loss was reflected in their conclusion. Besides that, cash flow statement was prepared for 2003.*
- 5. In accordance with local standards, the Company hasn't been presented an accounting balance to the proper control organs for December 31, 2004 and related statements on profit/loss. Those statements will be prepared after the audit for the period ending on December 31, 2004 and later approved by the auditor. The deadline for handing statements is on May 31, 2005.*
- 6. In accordance with Item 4, the Company did not hold any required deposit reserves with National Bank of Azerbaijan Republic as of December 31, 2004, since it does not attract any deposits assets.*
- 7. In our opinion, presented financial statements in accordance with International accounting standards impartially and authentically reflect the Company's financial position, results of its operational activity and cash flow during the year ending December 31, 2004.*

CredAgro

Accounting Balance as of December 31, 2004

(in 1,000 AZM)

	comments	2004	(*) 2003
Assets			
Cash and short-term assets		5,211	4,552
Assets at correspondent bank accounts		1,252,914	2,221,547
Given credits		18,531,126	15,652,607
Main assets		495,162	237,760
Depreciation charges		(121,906)	(21,777)
Accrued interest		25,067	6,332
Other assets		64,933	189,320
Deferred taxation assets			
Total assets		20,252,507	18,290,341
Liabilities			
Other liabilities		37,000	128,603
Deferred taxable liabilities			
Total liabilities		37,000	128,603
Statutory fund		22,615	22,615
Retained income		5,407,228	3,490,970
Capital reserves		14,785,664	14,648,153
Total own capital		20,215,507	18,161,738
Total liabilities and own capital		20,252,507	18,290,341
Unexpected situations and potential liabilities			

Note:

Comments on pages 5-14 are an inherent part of this financial statement

CredAgro

Profit/Loss statement of year ending on December 31, 2004

(in 1.000 AZM)

	Comments	2004	(*) 2003
Interest income on loans		3,647,019	2,840,667
Interest income on securities			
Total interest income		3,647,019	2,840,667
Interest paid on borrowing costs			
Interest paid on deposits			
Total interest expenses			
Net interest income		3,647,019	2,840,667
Accrual sanctions for past-due loans			45,521
Loan Loss Reserve		(53,135)	(307,510)
Net interest income after Loan Loss Reserve		3,593,884	2,578,678
Donations to cover administrative expenses		113,855	414,151
Staff expenses		(1,101,394)	(589,182)
Bonus		(56,382)	(22,168)
Rent expenses		(96,281)	(47,062)
Other expenses		(537,424)	(111,586)
Profit/Loss before taxes		1,916,258	2,222,831
Profit tax			
Net Profit/Loss per year		1,916,258	2,222,831

Note:

Comments on pages 5-14 are an inherent part of this financial statement

CredAgro

Cash flow statement year ending December 31, 2004

(in 1.000 AZM)

	31 December		Changes for 2004		
	2004	2003	Main activity	Investing activity	Financial activity
Assets					
Cash	1,258,125	2,226,099			
Extended loans	18,768,962	15,837,308			(2,931,654)
Loan reserve	(237,836)	(184,701)			53,135
Fixed Assets	473,385	237,760		(236,625)	
Accumulated depreciation	(100,129)	(21,777)		78,352	
Accrued interest on past-due loans	25,067	6,332	(18,735)		
Other assets	18,696,507	189,320	(18,507,187)		
Deferred taxable assets, net amount					
Total Assets	38,884,081	18,290,341			
Liabilities					
Other liabilities	18,755,058	128,603	18,626,455		
Deferred taxable liabilities					
Total liabilities	18,755,058	128,603			
Statutory fund	22,615	22,615			
Retained income	5,407,228	3,490,970	1,916,258		
Capital reserve	14,699,188	14,648,153		51,035	
Total equity	20,129,023	18,161,738			
Total	38,884,081	18,290,341	2,016,791	(107,138)	(2,878,519)
Increase in cash					(968,966)

Note:

Comments on pages 5-14 are an inherent part of this financial statement

CredAgro

Comments on Financial Statements year ending December 31, 2004

(in 1.000 AZM)

Comment 1. Main activities of Organization

“CredAgro” Non-Banking Credit Organization (hereafter referred to as “the Company”) was established in the framework of the Agreement between governments of Azerbaijan Republic and USA for implementation of lending of rural credit. The Company’s operations are based on the general banking license provided by the National Bank of Azerbaijan Republic. The Company has 9 branches with Head Office in Baku. The Company is involved in one main type of activity (i.e. lending) and operates in one geographical area (i.e. Azerbaijan).

The economy of Azerbaijan has achieved certain results in reaching low inflation and stable exchange rate for the last years. However the economy of Azerbaijan depends on the oil prices to significant extent and fluctuations in these prices may have an impact on all spheres of economy including the sector of credit institutions.

We should also note that, as a result of some various reforms Azerbaijan Government has tried to create conditions for strengthening other fields of economy from the beginning of 2005. The bank sector and construction can be marked among them specially. Presence of huge weight of cash in an internal trade promoted a rising of the prices for the goods and services.

Comment 2. Bases of composing reporting

The Company conducts accounting and prepares financial statements according to local standards in compliance with “The Law on Organizations and Banking Activity” since June 14, 1996, tax legislation, procedures and instructions of National Bank. Subject financial statements were prepared on the basis of mentioned above reporting with corrections necessary for its compliance with International Accounting Standards (IAS) developed by International Committee of Accounting Standards (ICAS) except for the correction of interest accrual as it is required by IAS and set forth below. Accordingly, principles accounting policy was applied in Comment #3. Financial statements are expressed in national currency of Azerbaijan Republic, i.e. Azeri manats (AZM).

Comment 3. Principles of accounting policy

Following principles of accounting policy were applied in preparation of presented financial statements:

Accounting rules

Company’s statements were prepared based on the principle of initial cost in accordance with applicable IAS, except it was not corrected in regard to interest accrual as it is required by IAS and set forth in details below.

CredAgro

Comments on Financial Statements year ending December 31, 2004

(in 1.000 AZM)

Comment 3: Principles of accounting policy (sequel)

Cash and equivalents

For cash flow statement purposes cash and equivalents include cash in hand, balance in accounts at National Bank (excluding required reserves), correspondent bank accounts including short-term deposits and investments in other organizations.

Loan Loss Reserve

Loans are presented as a balance for the year-end excluding Loan Loss Reserve. General reserves were created for doubtful and loss loans. They potentially were included in loan portfolio but had not been reflected by the date of preparation of financial statements. Aggregate reserves created during the year played role in reduction of a revenue for the year. CredAgro forms reserves proceeding from normative position International Bank from January, 27 2001 №2660 (which is intended for the credit unions) and the average % rates which are accepted in the market of non-banking credit organizations of Azerbaijan. 1 % scale is established for the normal credits. According to the accepted form of the report – International bank agrees with practice of norm securing of obligatory reserves of CredAgro. Our recommendations are considering the possibility of increasing a scale for normal credits up to 2 %.

Calculation of future losses requires rough estimations and use of assumptions. These are considered to be fundamental factors in determining reserves: size, composition and quality of loan portfolio, volume of past-due loans, current economic situation, value and adequacy of assets proposed as collateral.

Figures show qualitative change of a credit portfolio aside integration (increase) in the sums of credits for one borrower. This is a normal practice by way of improvement of quality of a portfolio and reduction of operational costs on carrying out of credit work CredAgro.

Credits which cannot be repaid are written off due to reserves on hopeless and doubtful duties. Write-off is carried out after the end of all necessary legal procedures and final definition of the sum of the loss. Repayment of credits on which the reserve has been earlier formed, is reflected as reduction of reserve deductions on hopeless and doubtful duties for a year.

We lead the stop check with scope in order of 10%-borrowers.

Check was carried out on categories (the main characteristics of credits): the purpose of the credit; the sum of the credit; the order of repayment; term; securing of the credit; establishing of the interest rate; other conditions.

The system of conducting credit documents and system of forming of qualitative pledges have been checked up as well. The purpose of the credit serves as the important indicator of a degree of the risk connected on delivering of the credit. Very

CredAgro

Comments on Financial Statements year ending December 31, 2004

(in 1.000 AZM)

Comment 3: Principles of accounting policy (sequel)

important element for business deal is that the borrower can present as a security for credit. Proper attention is being paid regarding the securing in fulfillment of credit transactions CredAgro.

According to operating state and normative base of International Bank, a special-purpose designation and quality of borrowers' pledge of CredAgro is adequately a credit contract.

Buildings and the equipment

Buildings and the equipment are reflected on cost or the sum of reassessment behind a minus of the saved up amortization.

There was no reassessment of the main assets in the Organization.

Comment 3: Principals of accounting policy (sequel)

If charges on repair and technical service of buildings and the equipment, including repair of rented office buildings, result in substantial improvement or prolongation of useful validity of corresponding actives they are capitalized as the subsequent capital investments in rented assets. Amortization on the given actives is charged according to item 114 of the Tax Code during all prospective useful validity of the given actives. Other expenses for repair and technical service, concern on reduction of the profit.

Registration of incomes and expenses

In the Organization incomes and charges are reflected in the report not on a charge method, but on a method of their implementation (they are reflected as incomes at the moment of implementation of operation), that in turn contradicts ISBA and also to item 4 of the instruction of conducting calculation, confirmed by IBAR since 14.02.2001. The organization explains such method of account insufficient under opportunities existing program.

Operation with foreign currency

An exchange rate of National Bank existing for current business day is applied to operations in foreign currency. Exchange rate difference created in the result of operations in foreign currency is included in profit/loss for the date of exchange operation.

All assets and liabilities in foreign currency are converted into manats applying official exchange rate of National Bank for the date when balance is prepared. Any profit/loss originated from exchange rate difference during the re-evaluation of assets and liabilities is reflected on profit/loss statement as net profit/loss from foreign currency conversion. Main exchange rate for December 31, 2003 applied for re-evaluation of ending balance of accounts in foreign currency was 4,903 AZM per USD (for 2002: 4,893 AZM, 2003: 4,923 AZM per USD.)

CredAgro

Comments on Financial Statements year ending December 31, 2004

(in 1.000 AZM)

Comment 3: Principles of accounting policy (sequel)

Financial instruments

Because of the nature of its operations the Company incurs different kinds of risk, including foreign currency, interest rate and liquidity, as well as credit risk. These risks are managed by using interchangeable positions and constant monitoring of risk conditions and financial markets. The bank does not use any derivative financial instruments to manage these risks.

Interest Rate risk

CredAgro applies only two (18 % and 25 % annuals) kinds of fixed rates. Application of such rates level provides real opportunities for profitableness of portfolio. 18 % and 25 % annuals are adequate in the home trade of Azerbaijan and correspond to market condition present day. There is no need reconsidering or entering floating rates, taking into consideration economic forecasts to 2006 for CredAgro. The conservative approach of CredAgro in creating interest rates is expedient in real economic conditions for rural economy of Azerbaijan.

As known, the percentage risk, or risk of changing interest rates, this is a dependence of profit of CredAgro on fluctuation of % rates in the market. The given risk group is insignificant now.

Definition of risk groups

We lead the analysis of reserves and relation dynamic on normal and risk credits. CredAgro (as non-banking credit organization) has to deduct assets in reserve fund which is created for compensation of losses from unreturned credits for each credit.

2004 (1.000 manat)				
	1 quarter	2 quarter	3 quarter	4 quarter
Reserves— normal credits	171777.0	174595.0	186844.0	186599.0
Reserves Risk credits for 10% covering	-	-	-	5830.0
Reserves Risk credits for 60% covering	6720.0	18535.0	913.0	-
Reserves Risk credits for 100% covering	24490.0	31113.0	117752.0	45406.0
% treatment Total reserves to risk credit 100%	14,25%	17,82%	63,02%	24,33%
Total treatments reserve to portfolio	1,17%	1,27%	1,62%	1,267%

CredAgro

Comments on Financial Statements year ending December 31, 2004

(in 1.000 AZM)

Comment 3: Principles of accounting policy (sequel)

Regarding the reporting on 31.12.2004 the sum of unreturned credits of the highest groups of risk makes 45406000 manat (\$9250). 0,25 % from all portfolio that does not represent any significant threats, but demands strengthening the attention, this is nothing else but as opportunity of credit risks forming. The credit risk means possibility of financial losses in the result of non-fulfillment of liabilities by borrowers that is expressed in a non-returned (in full or in part) of the basic debt sum and interests on it in the established deadline by the contract. The threat of excess of risk reserves above the basic reserves is shown in 3 quarter. It is inadmissible norm for all kinds of the credit organizations.

Comment 4. The analysis of control system of credit portfolio

CredAgro has launched the new program (RS Bank 5.01) in December 2004. The Loan Tracking system has been applied in the organization up to this time.

In the result of studying it is revealed, that the data for 2004 are not yet included to new system RS Bank 5.01.

We recommend to IT experts of CredAgro to develop modules of general reports on branch distribution, branch structure, interest incomes and credit works of CredAgro within 1st quarter 2005. Besides this we suggest to establish an additional server and organize on its base reserve operational control centre in one of the branches CredAgro as well. The without fail practice of creation is already applied to the bank organizations - the reserve operational centers (on the basis of their branches) in Azerbaijan today. It is obvious, that for CredAgro, having stable positions in the credit market of Azerbaijan will create opportunity guarantees of regular work of all structures CredAgro in case of unforeseen – extreme situations such as loss of the data on computers at the central office.

Graphic of collecting

The organization has good parameters/activities on a reflexivity of credits which makes 99 %. But CredAgro does not create summary schedules on reflexivity both on branches and central office.

Insurance

The insurance policies serving as a secondary source of repayment of loans concern to the credit documentation. It is necessary, that the insurance policies were certainly applied in the documentation list of borrowers' credit history. In the legal relation they should define precisely mutual relations of the sides allowing protect interests of the Organization. The positive practice of the conclusion of tripartite contracts of the guarantee and contracts of insurance pays attention to itself in this connection. Including such contracts of the Organization into number of participants raise their efficiency as it does not allow changing condition of mutual relations of the borrower and the guarantor (insurer) without his permission. There already were facts in practice in Azerbaijan when at the bilateral contract of insurance the borrower annulled a treaty after receiving the loan, the creditor learned about it with

CredAgro

Comments on Financial Statements year ending December 31, 2004

(in 1.000 AZM)

Comment 4. The analysis of control system of credit portfolio

big delay, so he could not change the situation any more and the reflexivity of the credit became not guaranteed. For borrowers over \$30000 obviously expediently to enter practice of insurance of the borrower with a condition of payment to the borrower of the insurance premium in a case not approaches of an insurance case. It is even the stimulating mechanism. The insurance company Bashak-Inam provides the fulfillment of the complex contract for the Organization at present. The reputation of insurance company Bashak-Inam does not cause any doubts and the established list of insurance tasks is adequate to mission of the Organization. We suggest developing the version – tripartite contract together with the insurance company and beginning practice of their application.

Comment 5: Cash and short-term assets

	2003	2004
Cash	4,552	5,211
Funds in correspondent bank accounts	2,221,547	1,252,914
- in Azerbaijan Republic		
- other countries		
Total cash and short-term assets, net amount	2,226,099	1,258,125

According to instructions IBAR, the credit organization should hold reserve deposits from the rests on passive accounts which are charged monthly with use of the average day time rest. However CredAgro has no passive accounts (involved deposits) and therefore is exempted from storage of obligatory deposits in IBAR.

Comment 6: Paid out loans

	2003	2004
Outstanding loans	15,719,351	18,633,832
Past-due loan	117,957	135,130
Total paid out loans to clients	15,837,308	18,768,962
Minus: reserves to possible losses on doubtful and hopeless loans	184,701	237,836
Total given credits to clients – net amount	15,652,607	18,531,126

CredAgro**Comments on Financial Statements for the year ending on December 31, 2004**
(in 1.000 AZM)**Comment 6: Paid out loans**

Movement on reserves to possible losses on doubtful and hopeless loans

	2003	2004
Reserves to possible losses on doubtful and hopeless loans loan on January 1	65,833	184,701
Deduction from income on covering doubtful and hopeless loans per year	118,868	53,135
Reserves on possible losses on doubtful and hopeless loans on December 31	184,701	237,836

The structure of credit portfolio of Organization on economic fields is shown below.

	2004	%
Crops	11,012,416	59
Trade loans	5,623,741	30
Processing loans	902,152	5
Other loans	858,025	4
Service loans	372,628	2
Total credits to clients		100.0%

The interest rate on credits to clients in US dollars within one year varied from 18 % up to 24 %.

The structure on terms of repayment of loan portfolio is stated in details below.
The distributed credits in 2004 year

	2004	Plan	Fact
1	January	313 000,0	391 900,0
2	February	318 000,0	323 900,0
3	March	588 500,0	471 700,0
4	April	620 000,0	516 300,0
5	May	460 000,0	262 700,0
6	June	345 000,0	274 700,0
7	July	322 000,0	452 400,0
8	August	337 000,0	481 100,0
9	September	330 000,0	505 300,0
10	October	360 000,0	441 800,0
11	November	360 000,0	526 100,0
12	December	339 500,0	504 500,0
	Total in 2004	4 693 000,0	5 152 400,0

Note:

Comments on pages 5-14 are an inherent part of this financial statement

CredAgro**Comments on Financial Statements for the year ending on December 31, 2004**
(in 1.000 AZM)**Comment 6: Paid out loans**

Return of credits in 2004

	2004	Plan	Fact
1	January	352 145,0	350 463,9
2	February	292 645,0	288 025,2
3	March	298 400,0	324 999,6
4	April	287 300,0	302 092,6
5	May	301 250,0	297 169,6
6	June	323 040,0	338 820,5
7	July	336 300,0	370 303,0
8	August	360 700,0	433 162,0
9	September	375 450,0	409 401,0
10	October	372 350,0	443 827,9
11	November	336 050,0	471 009,2
12	December	346 600,0	483 915,8
	Total in 2004	3 982 230,0	4 513 190,2

Comment 7: Buildings and equipment

	Settings, furniture and others	Computers and other office equipments	Transport	Total
Balance as of January 1, 2004.				
Cost or evaluation				
Initial balance	19,034	25,227	193,499	
Entry	25,750	150,140	83,856	
Removal	2,304	40		
Outgoing balance	42,480	175,327	277,355	495,162
Accumulated depreciation				
Initial balance	67	67	21,643	21,777
Deduction on depreciation	4,596	31,317	64,216	100,129
Removal				
Outgoing balance	4,663	31,384	85,859	121,906
Balance on December 31, 2004	38,651	142,297	192,308	373,256

CredAgro**Comments on Financial Statements for the year ending on December 31, 2004**
(in 1.000 AZM)**Comment 8: Other liabilities**

	2003	2004
Accumulated expenses	128,603	
Income tax, deduction and other taxes		64,177
Other		18,631,881
Total other liabilities	128,603	18,696,058

Comment 9: Statutory capital

Announced statutory capital of the Company for December 31, 2004 is 22616,0 thousand AZM which is fully paid. Shared capital of the Company in amount 22616,0 AZM consists of following shares:

Founder	Amount	Share %
ACDI/VOCA	22,615	100
Total share capital	22,615	100

Comment 10: General, administrative and other operational expenses

	2004
Salary	1,101,394
Reward	56,382
Fuel and vehicle maintenance	50,298
Phone expenses	36,528
Rent charges	96,281
Stationery	35,518
Travel expenses	73,332
Representative expenses	11,412
Auditing	13,000
Printing	1,500
Depreciation	100,129
Courier expenses	6,660
Others	209,047
Total general, administrative and other operational expenses	1,791,481

Note:

Comments on pages 5-14 are an inherent part of this financial statement

CredAgro

Comments on Financial Statements for the year ending on December 31, 2004 (in 1.000 AZM)

Comment 11: Taxation

According to chapter 1 of the Contract about mutual cooperation with view of simplification of rendering assistance between the Governments of Azerbaijan and the USA which is ratified by the Parliament of the Azerbaijan Republic and confirmed by the President in 18.07.2000, it is mentioned that the individuals participating within the framework of the aid programs taking part by the Government of USA are exempted from all taxes and tariffs.

On the basis of the letter of the USA Embassy in Azerbaijan in 09.05.2000, directed to the Ministry of Taxes of Azerbaijan, is specified, that the Organization operates within the framework of the Contract about mutual aid and therefore the taxation and deductions were carried out on the basis of chapter 1 of the above-stated Contract.

Comment 12: Risks Management

Risk of the interest rate

The organization doesn't run the risk of the interest rate as a result of delivering/giving out of credits to legal and physical individuals, as a result of that it has no debt deposit holding (differences on the established interest rates and interest rates of deposits and the other borrowed assets does not exist).

Comment 13: Unforeseen circumstances and potential obligations.

Juridical procedures.

As of December 31, 2004 CredAgro had been involved in legal actions. The Organization has submitted 10 claims to judicial instances within 2004. In six cases after judicial intervention the all arrears were repaid clients, in one case the Organization cancelled debt of the borrower, and in rest three the court has satisfied the claim of the Organization on consideration.

Tax legislation

During the conducted audit incorrect accumulation of income tax, tax in source, social deduction, during the entire financial year was revealed. The sums of not charged taxes and social deductions have been presented to account department. Submission of elaborated report and payment of amount is recommended in order to avoid financial penalties by tax inspectorate.

Taking into consideration that fact, that the Organization has been exempted from payment of many kinds of the taxes used in Azerbaijan, that the period of exempting of payment comes to the end in May 2005, and also that there were offences during all its activity in the field of tax legislation in the organization, we think that the Organization requires improvement of knowledge in the field of the taxation and necessity of corresponding consultations.

CredAgro

Comments on Financial Statements for the year ending on December 31, 2004 (in 1.000 AZM)

Comment 13: Unforeseen circumstances and potential obligations.

Loan obligations

Loan obligations include obligations related to extended loans. Contracted amount should be determined taking into consideration the risk of failure by a borrower to fulfill his/her obligations as well as depreciation of value of collateral. All loans given by CredAgro have full recovery in a form of collateral with different types of liquidity and consequently, CredAgro incurs minimum risk.

Marketing strategy of a credit policy

Now the majority of the commercial organizations (the organizations which have saved up definite experience of the credit transactions) are not limited in presence of credit structures and experts, activity taken to the conclusion and fulfillment of credit contracts. Not only bank structures, but many non-banking organizations have experts not only on marketing but also forming of public image.

Questions on marketing researches of the credit market of Azerbaijan, strategic planning, the analysis and legal maintenance of credit process are not solved in CredAgro. In result CredAgro has the certain problems with creation reliable protection against credit risk for itself and preparation of perspective plans for work in the market.

It is possible to allocate two main types of strategy in developing conditions – capable to provide to non-banking credit organizations successfully growth of volumes of business and at the same time saving stability to possible credit risks. The first is focusing on most quickly growing, but also inevitable more risky segments of demand for the credit. The second type is strengthening positions in crediting highly reliable segments of borrowers.

Recommendations: It is necessary considering an opportunity and including in the staff of the marketing expert with the basic direction on rural economy of Azerbaijan for CredAgro. And in accordance with it to carry out the analysis regularly which has allowed allocating branches with higher and lower level of credit risks concerning an average index on the credit market.

