

**CLOSED JOINT STOCK  
COMPANY ACCESS  
BANK (formerly Closed  
Joint Stock Company  
Micro Finance Bank of  
Azerbaijan)**

**Financial Statements**

For the Year Ended 31 December 2008

# CLOSED JOINT STOCK COMPANY ACCESSBANK (FORMERLY CJSC MICRO FINANCE BANK OF AZERBAIJAN)

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# CLOSED JOINT STOCK COMPANY ACCESSBANK (FORMERLY CJSC MICRO FINANCE BANK OF AZERBAIJAN)

## STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

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The following statement, which should be read in conjunction with the independent auditors' responsibilities stated in the independent auditors' report set out on pages 2-3, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the financial statements of Closed Joint Stock Company AccessBank (the "Bank").

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Bank as at 31 December 2008, 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:

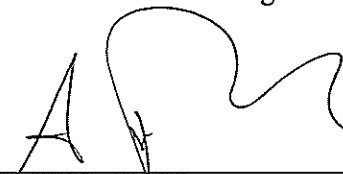
- Selecting suitable accounting principles and applying them consistently;
- Making judgments and estimates that are reasonable and prudent; and
- Preparing the financial statements on a going concern basis, unless it is inappropriate to presume that the Bank will continue in business for the foreseeable future.

Management is also responsible for:

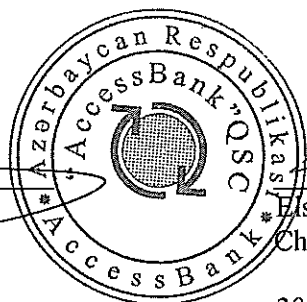
- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Bank;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Bank, and which enable them to ensure that the financial statements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

The financial statements for the year ended 31 December 2008 were authorized for issue on 20 April 2009 by the Management Board.

On behalf of the Management Board:

  
\_\_\_\_\_  
Andrew Pospelovsky  
Chairman of the Management Board

20 April 2009



  
\_\_\_\_\_  
Eshan Hajiyev  
Chief Accountant

20 April 2009

## **INDEPENDENT AUDITORS' REPORT**

To the Shareholders and the Supervisory Board of Closed Joint Stock Company AccessBank:

### **Report on the financial statements**

We have audited the accompanying financial statements of CJSC AccessBank (formerly CJSC Micro Finance Bank of Azerbaijan), which comprise the balance sheet as at 31 December 2008, the income statement, the statements of changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### **Management's responsibility for the financial statements**

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

### **Auditors' responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the financial statements present fairly, in all material respects the financial position of CJSC AccessBank as at 31 December 2008, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

*Deloitte, Touche LLC*

20 April 2009  
Baku, the Republic of Azerbaijan


**CLOSED JOINT STOCK COMPANY ACCESS BANK (FORMERLY CJSC MICRO FINANCE BANK OF AZERBAIJAN)**

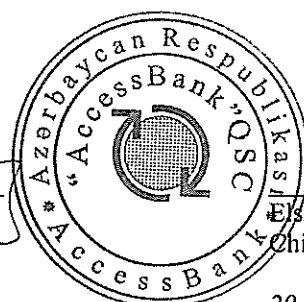
**INCOME STATEMENT  
FOR THE YEAR ENDED 31 DECEMBER 2008**


*(in AZN and in thousands, except for earnings per share which are in AZN)*

	Notes	Year ended 31 December 2008	Year ended 31 December 2007
Interest income	4, 25	42,540	20,855
Interest expense	4, 25	<u>(12,544)</u>	<u>(6,643)</u>
NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS		29,996	14,212
Provision for impairment losses on loans to customers	5	<u>(2,116)</u>	<u>(1,111)</u>
NET INTEREST INCOME		<u>27,880</u>	<u>13,101</u>
Net gain on foreign exchange operations	6	396	54
Fee and commission income	7	2,784	1,490
Fee and commission expense	7	(200)	(187)
Other income		678	409
Provision for impairment losses on other assets	5	<u>(120)</u>	<u>-</u>
NET NON-INTEREST INCOME		<u>3,538</u>	<u>1,766</u>
OPERATING INCOME		31,418	14,867
OPERATING EXPENSES	8, 25	<u>(18,005)</u>	<u>(10,055)</u>
PROFIT BEFORE INCOME TAX		13,413	4,812
Income tax expense	9	<u>(2,958)</u>	<u>(1,213)</u>
NET PROFIT		<u>10,455</u>	<u>3,599</u>
EARNINGS PER SHARE			
Basic and Diluted (AZN)	10	<u>0.66</u>	<u>0.37</u>

On behalf of the Management Board:

  
Andrew Pospelovskiy  
Chairman of the Management Board



  
Elshan Hajiyev  
Chief Accountant

20 April 2009

20 April 2009



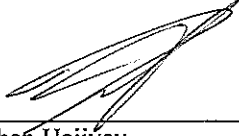
The notes on pages 9-48 form an integral part of these financial statements.

**CLOSED JOINT STOCK COMPANY ACCESS BANK (FORMERLY CJSC MICRO FINANCE BANK OF AZERBAIJAN)**

**BALANCE SHEET**  
**AS AT 31 DECEMBER 2008**  
*(in AZN and in thousands)*

	Notes	31 December 2008	31 December 2007
<b>ASSETS</b>			
Cash and balances with the National Bank of Azerbaijan	11	10,041	6,485
Due from banks	12	7,334	2,236
Loans to customers	13,25	163,669	93,977
Investment available-for-sale	14	5,863	5,293
Investment held to maturity	15	125	-
Property, equipment and intangible assets	16,25	6,104	3,576
Deferred income tax asset	9	-	31
Other assets	17,25	779	1,038
<b>TOTAL ASSETS</b>		<b>193,915</b>	<b>112,636</b>
<b>LIABILITIES AND EQUITY</b>			
<b>LIABILITIES</b>			
Loans from shareholders	18, 25	19,664	10,367
Due to banks and other financial institutions	19	116,578	75,603
Customer accounts	20, 25	21,852	12,134
Current income tax payable		1,754	440
Deferred income tax liability	9	12	-
Other liabilities	21	756	248
<b>Total liabilities</b>		<b>160,616</b>	<b>98,792</b>
<b>EQUITY</b>			
Share capital	22	20,000	11,000
Retained earnings		13,299	2,844
<b>Total equity</b>		<b>33,299</b>	<b>13,844</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>193,915</b>	<b>112,636</b>

On behalf of the Management Board:

Andrew Pospelovsky  
 Chairman of the Management Board

Elshan Hajiye  
 Chief Accountant

20 April 2009

20 April 2009


The notes on pages 9-48 form an integral part of these financial statements.

**CLOSED JOINT STOCK COMPANY ACCESS BANK (FORMERLY CJSC MICRO FINANCE BANK OF AZERBAIJAN)**

**STATEMENT OF CHANGES IN EQUITY  
FOR THE YEAR ENDED 31 DECEMBER 2008  
(in AZN and in thousands)**

	Share capital	Retained earnings / (accumulated deficit)	Total equity
<b>31 December 2006</b>	6,713	(755)	5,958
Issue of ordinary shares	4,287	-	4,287
Net profit	-	3,599	3,599
<b>31 December 2007</b>	11,000	2,844	13,844
Issue of ordinary shares	9,000	-	9,000
Net profit	-	10,455	10,455
<b>31 December 2008</b>	<b>20,000</b>	<b>13,299</b>	<b>33,299</b>

On behalf of the Management Board:

  
Andrew Pospelovsky  
Chairman of the Management Board



  
Elshan Hajiyev  
Chief Accountant

20 April 2009

20 April 2009

The notes on pages 9-48 form an integral part of these financial statements.

**CLOSED JOINT STOCK COMPANY ACCESS BANK (FORMERLY CJSC MICRO FINANCE BANK OF AZERBAIJAN)**

**STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED 31 DECEMBER 2008  
(in AZN and in thousands)**

	Notes	Year ended 31 December 2008	Year ended 31 December 2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Profit before income tax		13,413	4,812
Adjustments for:			
Provision for impairment losses on interest bearing and other assets	5	2,236	1,111
Depreciation and amortization	16	947	664
Translation loss on foreign exchange operations	6	(2)	77
Change in interest accruals, net		615	520
Cash flows from operating activities before changes in operating assets and liabilities		17,209	7,184
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposit with the National Bank of Azerbaijan		87	(787)
Due from banks		(3,828)	713
Loans to customers		(71,073)	(51,293)
Other assets		259	(635)
Increase/(decrease) in operating liabilities:			
Loans and advances from shareholders and financial institutions		49,090	43,514
Customer accounts		9,432	8,490
Other liabilities		508	221
Cash inflow from operating activities before taxation		1,684	7,407
Income tax paid		(1,601)	(720)
Net cash inflow from operating activities		83	6,687
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchase of property, equipment and intangible assets	16	(3,475)	(2,644)
Purchase of investments available-for-sale		(695)	(5,253)
Net cash outflow from investing activities		(4,170)	(7,897)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Issue of ordinary share capital	22	9,000	4,287
Net cash inflow from financing activities		9,000	4,287
Effect of changes in foreign exchange rate on cash and cash equivalents		1	86
NET INCREASE IN CASH AND CASH EQUIVALENTS		4,913	3,163
CASH AND CASH EQUIVALENTS, beginning of year	11	6,953	3,790
CASH AND CASH EQUIVALENTS, end of year	11	11,867	6,953

**CLOSED JOINT STOCK COMPANY ACCESS BANK (FORMERLY CJSC MICRO FINANCE BANK OF AZERBAIJAN)**



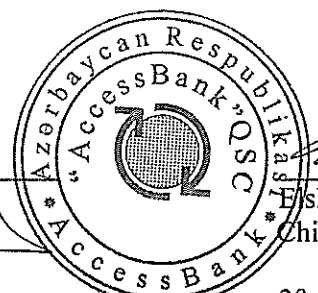

**STATEMENT OF CASH FLOWS (CONTINUED)  
FOR THE YEAR ENDED 31 DECEMBER 2008**  
*(in AZN and in thousands)*

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Interest paid and received by the Bank during the year ended 31 December 2008 amounted to AZN 11,077 thousand and AZN 41,687 thousand, respectively.

Interest paid and received by the Bank during the year ended 31 December 2007 amounted to AZN 5,636 thousand and AZN 21,585 thousand, respectively.

On behalf of the Management Board:

			
Andrew Pospelovsky Chairman of the Management Board			Eshhan Hajiyev Chief Accountant
<i>20 April 2009</i>			<i>20 April 2009</i>

The notes on pages 9-48 form an integral part of these financial statements.

# CLOSED JOINT STOCK COMPANY ACCESS BANK (FORMERLY CJSC MICRO FINANCE BANK OF AZERBAIJAN)

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008 (in AZN and in thousands, except for per share data)

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### 1. ORGANIZATION

Closed Joint Stock Company AccessBank (the “Bank”) is a closed joint-stock bank, which was incorporated in the Azerbaijan Republic on 5 September 2002 as CJSC Micro Finance Bank of Azerbaijan. The Bank is regulated by the National Bank of Azerbaijan (the “NBA”) and conducts its business under license number 245. From 6 September 2008 the Bank changed its legal name from CJSC Micro Finance Bank of Azerbaijan to CJSC AccessBank. The Bank’s primary business consists of originating small and micro loans to legal entities and individuals.

The registered office of the Bank is located at B. Safaroglu Street, 176, Baku, Azerbaijan.

The Bank has 20 and 13 branches operating in Azerbaijan as at 31 December 2008 and 2007, respectively.

As at 31 December 2008 and 2007, the following shareholders owned the issued shares of the Bank:

	31 December 2008, %	31 December 2007, %
International Finance Corporation	20.00	20.00
Black Sea Trade and Development Bank	20.00	20.00
Kreditanstalt für Wiederaufbau	20.00	20.00
European Bank for Reconstruction and Development	20.00	20.00
Access Holding	16.53	16.53
LFS Financial Systems	3.47	3.47
<b>Total</b>	<u>100.00</u>	<u>100.00</u>

These financial statements were authorized for issue by the Management Board of the Bank on 20 April 2009.

### 2. BASIS OF PRESENTATION

#### Accounting basis

These financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board (“IASB”) and Interpretations issued by the International Financial Reporting Interpretations Committee (“IFRIC”).

These financial statements are presented in thousands of Azerbaijan Manats (“AZN”), unless otherwise indicated. These financial statements have been prepared under the historical cost convention, except for the measurement at fair value of certain financial instruments.

The Bank maintains its accounting records in accordance with Azerbaijani law. These financial statements have been prepared from the Azerbaijani statutory accounting records and have been adjusted to conform to IFRS. These adjustments include certain reclassifications to reflect the economic substance of underlying transactions including reclassifications of certain assets and liabilities, income and expenses to appropriate financial statement captions.

### *Functional currency*

Items included in the financial statements of the Bank are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that entity (the “functional currency”). The functional currency of the financial statements is the Azerbaijani Manats.

## **3. SIGNIFICANT ACCOUNTING POLICIES**

### **Recognition and measurement of financial instruments**

The Bank recognizes financial assets and liabilities on its balance sheet when it becomes a party to the contractual obligations of the instrument. Regular way purchases and sales of financial assets and liabilities are recognized using settlement date accounting. Regular way purchases of financial instruments that will be subsequently measured at fair value between trade date and settlement date are accounted for in the same way as for acquired instruments.

Financial assets and liabilities are initially recognized at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to acquisition or issue of the financial asset or financial liability. The accounting policies for subsequent re-measurement of these items are disclosed in the respective accounting policies set out below.

### **Cash and cash equivalents**

Cash and cash equivalents include cash on hand, unrestricted balances on correspondent and time deposit accounts with the National Bank of Azerbaijan with original maturity within 90 days, advances to banks in countries included in the Organization for Economic Co-operation and Development (“OECD”). For purposes of determining cash flows, the minimum reserve deposit required by the National Bank of Azerbaijan is not included as a cash equivalent due to restrictions on its availability.

### **Due from banks**

In the normal course of business, the Bank maintains advances and deposits for various periods of time with other banks. Due from banks are initially recognized at fair value. Due from banks with a fixed maturity term are subsequently measured at amortized cost using the effective interest method, and are carried net of any allowance for impairment losses. Those that do not have fixed maturities are carried at amortized cost based on expected maturities. Amounts due from credit institutions are carried net of any allowance for impairment losses.

### **Loans to customers**

Loans to customers are non-derivative assets with fixed or determinable payments that are not quoted in an active market, other than those classified in other categories of financial assets.

Loans to customers granted by the Bank are initially recognized at fair value plus related transaction costs, where the fair value of consideration given does not equal the fair value of the loan, for example where the loan is issued at lower than market rates, the difference between the fair value of consideration given and the fair value of the loan is recognized as a loss on initial recognition of the loan and included in the income statement according to nature of the losses. Subsequently, loans are carried at amortized cost using the effective interest method. Loans to customers are carried net of any allowance for impairment losses.

## **Write off of loans and advances**

Loans and advances are written off against the allowance for impairment losses when deemed uncollectible. Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Bank and after the Bank has sold all available collateral. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in the income statement in the period of recovery.

## **Allowance for impairment losses**

### *Assets carried at amortized cost*

The Bank accounts for impairment losses of financial assets when there is objective evidence that a financial asset or group of financial assets is impaired. Impairment losses are measured as the difference between carrying amounts and the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted at the financial asset's original effective interest rate.

Such impairment losses are not reversed, unless 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 recoveries, in which case the previously recognized impairment loss is reversed by adjustment of an allowance account.

For financial assets carried at cost, impairment losses are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows, discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

The determination of impairment losses is based on an analysis of the risk assets and reflects the amount which, in the judgment of management, is adequate to provide for losses incurred. Provisions are made as a result of an individual appraisal of risk assets for financial assets that are individually significant, and an individual or collective assessment for financial assets that are not individually significant.

The change in impairment losses is charged to profit, and the total of impairment losses is deducted in arriving at assets as shown in the balance sheet. Factors that the Bank considers in determining whether it has objective evidence that an impairment loss has been incurred include information about the debtors' or issuers' liquidity, solvency and business and financial risk exposures, levels of and trends in delinquencies for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees. These and other factors may, either individually or taken together, provide sufficient objective evidence that an impairment loss has been incurred in a financial asset or group of financial assets.

The Bank accounts for impairment losses on financial assets at amortised cost using allowance account, for financial assets measured at cost through direct write off.

It should be understood that estimates of losses involve an exercise of judgment. While it is possible that in particular periods the Bank may sustain losses that are substantial relative to the allowance for impairment losses, it is the judgment of management that the allowance for impairment losses is adequate to absorb losses incurred on the risk assets.

### *Available-for-sale financial assets*

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in the income statement, is transferred from equity to the income statement. Reversals of impairment losses in respect of equity instruments classified as available-for-sale are not recognized in the income statement. Reversals of impairment losses on debt instruments are reversed through the income statement if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in the income statement.

## **Derecognition of financial assets and liabilities**

### *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 Bank 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 under a 'pass-through' arrangement; and
- the Bank either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial asset is derecognized when it has been transferred and the transfer qualifies for derecognition. A transfer requires that the Bank either: (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Bank reassesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. If substantially all the risks and rewards have been retained, the asset remains on the balance sheet. If substantially all of the risks and rewards have been transferred, the asset is derecognized. If substantially all the risks and rewards have been neither retained nor transferred, the Bank assesses whether or not it has retained control of the asset. If it has not retained control, the asset is derecognized. Where the Bank has retained control of the asset, it continues to recognize the asset to the extent of its continuing involvement.

### *Financial liabilities*

A financial liability is derecognized when the obligation is discharged, 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 de-recognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the income statement.

## **Investments held to maturity**

Investments held to maturity are debt securities with determinable or fixed payments. The Bank has the positive intent and ability to hold them to maturity. Such securities are carried at amortized cost using the effective interest method, less any allowance for impairment. Amortized discounts are recognized in interest income over the period to maturity using the effective interest method.

## **Investments available-for-sale**

Investments available-for-sale represents debt and equity investments that are intended to be held for an indefinite period of time. Investments available-for-sale are initially recorded at fair value and subsequently measured at fair value, with such re-measurement recognized directly in equity, except for impairment losses, foreign exchange gains or losses and interest income accrued using the effective interest method, which are recognized directly in the income statement. When sold, the gain/loss previously recorded in equity is recycled through the income statement. The Bank uses quoted market prices to determine the fair value for the Bank's investments available-for-sale. If the market for investments is not active, the Bank establishes fair value by using valuation techniques. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the Bank uses that technique.

Non-marketable debt and equity securities are stated at amortized cost and cost, respectively, less impairment losses, if any, unless fair value can be reliably measured.

When there is objective evidence that such securities have been impaired, the cumulative loss previously recognized in equity is removed from equity and recognized in the income statement for the period. Reversals of such impairment losses on debt instruments, which are objectively related to events occurring after the impairment, are recognized in the income statement for the period. Reversals of such impairment losses on equity instruments are not recognized in the income statement.

### **Property, equipment and intangible assets**

Property, equipment and intangible assets are stated at cost less accumulated depreciation and accumulated impairment losses.

Depreciation and amortization is charged on the carrying value of property, equipment and intangible assets and is designed to write off assets over their useful economic lives. Depreciation and amortization is calculated on a straight line basis at the following annual prescribed rates:

Buildings and leasehold improvements	10%-20%
Furniture and fixtures	25%
Computer equipment	25%
Vehicles	25%
Intangible assets	20%

Leasehold improvements are amortized over the life of the related leased asset. Expenses related to repairs and renewals are charged when incurred and included in operating expenses unless they qualify for capitalization.

The carrying amounts of property, equipment and intangible assets are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts. The recoverable amount is the higher of fair value less costs to sell and value in use. Where carrying values exceed the estimated recoverable amount, assets are written down to their recoverable amount, an impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation or amortization charge for property, equipment and intangible assets is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

### **Taxation**

Income tax expense represents the sum of the current and deferred tax expense.

The current tax expense is based on taxable profit for the year. Taxable profit differs from net profit before tax as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Bank's current tax expense is calculated using tax rates that have been enacted during the reporting period.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the balance sheet if:

- The Bank has a legally enforceable right to set off current income tax assets against current income tax liabilities; and
- Deferred income tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

Azerbaijan, where the Bank operates also has various other taxes, which are assessed on the Bank's activities. These taxes are included as a component of operating expenses in the income statement.

### **Loans from shareholders, Due to banks and other financial institutions and customer accounts**

Loans from shareholders, Due to banks and other financial institutions and customer accounts are initially recognized at fair value. Subsequently, amounts due are stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the income statement over the period of the borrowings, using the effective interest method.

### **Provisions**

Provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the obligation can be made.

### **Financial guarantee contracts issued and letters of credit**

Financial guarantee contracts and letters of credit issued by the Bank provide for specified payments to be made in order to reimburse the holder for a loss incurred such that payments are made when a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. Such financial guarantee contracts and letters of credit issued are initially recognized at fair value. Subsequently they are measured at the higher of (a) the amount recognized as a provision in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets"; and (b) the amount initially recognized less, where appropriate, cumulative amortization of initial premium revenue received over the financial guarantee contracts or letter of credit issued.

### **Contingencies**

Contingent liabilities are not recognized in the balance sheet but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognized in the balance sheet but disclosed when an inflow of economic benefits is probable.

### **Share capital**

Contributions to share capital are recognized at cost.

Dividends on ordinary shares are recognized in equity as a reduction in the period in which they are declared. Dividends that are declared after the balance sheet date are treated as a subsequent event under IAS 10 "Events after the Balance Sheet Date" ("IAS 10") and disclosed accordingly.

## Recognition of income and expense

### *Recognition of interest income and expense*

Interest income and expense are recognized 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 (or group of financial assets or financial liabilities) 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 or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

Once a financial asset or a group of similar financial assets has been written down (partly written down) as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest earned on assets at fair value is classified within interest income.

### *Recognition of fee and commission income and expense*

Loan origination fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the loan. Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in the income statement over the remaining period of the loan commitment. Where a loan commitment expires without resulting in a loan, the loan commitment fee is recognized in the income statement on expiry. Loan servicing fees are recognized as revenue as the services are provided. Loan syndication fees are recognized in the income statement when the syndication has been completed. All other commissions are recognized when services are provided.

## Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into AZN at the appropriate spot rates of exchange ruling at the balance sheet date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction. Profits and losses arising from these translations are included in net gain on foreign exchange operations.

## Rates of exchange

The exchange rates used by the Bank in the preparation of the financial statements as at year-end are as follows:

	31 December 2008	31 December 2007
USD/AZN	0.8010	0.8453
EUR/AZN	1.1292	1.2450

## Offset of financial assets and liabilities

Financial assets and liabilities are offset and reported net on the balance sheet when the Bank has a legally enforceable right to set off the recognized amounts and the Bank intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. In accounting for a transfer of a financial asset that does not qualify for de-recognition, the Bank does not offset the transferred asset and the associated liability.

## **Areas of significant management judgment and sources of estimation uncertainty**

The preparation of the Bank's financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the balance sheet date and the reported amount of income and expenses during the period ended. Management evaluates its estimates and judgments on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The following estimates and judgments are considered important to the portrayal of the Bank's financial condition.

### *Allowance for impairment of loans*

The Bank regularly reviews its loans to assess for impairment. The Bank's loan impairment provisions are established to recognize incurred impairment losses in its portfolio of loans and receivables. The Bank considers accounting estimates related to allowance for impairment of loans and receivables a key source of estimation uncertainty because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and receivables are based on recent performance experience, and (ii) any significant difference between the Bank's estimated losses and actual losses would require the Bank to record provisions which could have a material impact on its financial statements in future periods.

The Bank uses management's judgment to estimate the amount of any impairment loss in cases where a borrower has financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on past performance, past customer behavior, observable data indicating an adverse change in the payment status of borrowers in a Bank, and national or local economic conditions that correlate with defaults on assets in the Bank. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the Bank of loans. The Bank uses management's judgment to adjust observable data for a Bank of loans to reflect current circumstances not reflected in historical data.

The allowances for impairment of financial assets in the financial statements have been determined on the basis of existing economic and political conditions. The Bank is not in a position to predict what changes in conditions will take place in Azerbaijan and what effect such changes might have on the adequacy of the allowances for impairment of financial assets in future periods.

The carrying amount of the allowance for impairment of loans and receivables is AZN 4,116 thousand and AZN 1,987 thousand as at 31 December 2008 and 2007, respectively.

### *Valuation of Financial Instruments*

Financial instruments that are classified at fair value through profit or loss or available for sale, and all derivatives, are stated at fair value. The fair value of such financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. If a quoted market price is available for an instrument, the fair value is calculated based on the market price. When valuation parameters are not observable in the market or cannot be derived from observable market prices, the fair value is derived through analysis of other observable market data appropriate for each product and pricing models which use a mathematical methodology based on accepted financial theories. Pricing models take into account the contract terms of the securities as well as market-based valuation parameters, such as interest rates, volatility, exchange rates and the credit rating of the counterparty. Where market-based valuation parameters are not directly observable, management will make a judgment as to its best estimate of that parameter in order to determine a reasonable reflection of how the market would be expected to price the instrument. In exercising this judgment, a variety of tools are used including proxy observable data, historical data, and extrapolation techniques. The best evidence of fair value of a financial instrument at initial recognition is the transaction price unless the instrument is evidenced by comparison with data from observable markets. Any difference between the transaction price and the value based on a valuation technique is not recognized in the income

statement on initial recognition. Subsequent gains or losses are only recognized to the extent that it arises from a change in a factor that market participants would consider in setting a price.

The Bank considers that the accounting estimate related to valuation of financial instruments where quoted markets prices are not available is a key source of estimation uncertainty because: (i) it is highly susceptible to change from period to period because it requires management to make assumptions about interest rates, volatility, exchange rates, the credit rating of the counterparty, valuation adjustments and specific feature of the transactions and (ii) the impact that recognizing a change in the valuations would have on the assets reported on its balance sheet as well as its profit/(loss) could be material.

Had management used different assumptions regarding the interest rates, volatility, exchange rates, the credit rating of the counterparty and valuation adjustments, a larger or smaller change in the valuation of financial instruments where quoted market prices are not available would have resulted that could have had a material impact on the Bank's reported net income.

### **Adoption of new and revised standards**

In the current year, the Bank has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the "IASB") and the International Financial Reporting Interpretations Committee (the "IFRIC") of the IASB that are relevant to its operations and effective for annual reporting periods ending on 31 December 2008. The adoption of these new and revised Standards and Interpretations has not resulted in significant changes to the Bank's accounting policies that have affected the amounts reported for the current or prior years.

Amendments to IAS 1 "Capital Disclosures" ("IAS 1") – On 18 August 2005, the IASB issued an amendment to IAS 1 which requires certain disclosures to be made regarding the entity's objectives, policies and processes for managing capital. Additional information was disclosed in the financial statements for the current and comparative reporting periods as required by amended IAS 1.

Amendments to IAS 39, "Financial Instruments: Recognition and Measurement", and IFRS 7, "Financial Instruments: Disclosures", titled "Reclassification of Financial Assets" – On 13 October 2008 IASB issued amendments to IAS 39 and IFRS 7 which permits certain reclassifications of non-derivative financial assets (other than those designated as at fair value through profit or loss at initial recognition under the fair value option) out of the fair value through profit or loss category and also allow reclassification of financial assets from the available for sale category to the loans and receivables category in particular circumstances. The amendments to IFRS 7 introduce additional disclosure requirements if an entity has reclassified financial assets in accordance with the amendments to IAS 39. The amendments are effective as of 13 October 2008 and in certain circumstances can be applied retrospectively from 1 July 2008. The Bank has elected not to apply the amendments to IAS 39 and IFRS 7 retrospectively.

### **Standards and interpretations issued and not yet adopted**

At the date of authorization of these financial statements, other than the Standards and Interpretations adopted by the Bank in advance of their effective dates, the following Interpretations were in issue but not yet effective.

**IFRIC 9** “Reassessment of Embedded Derivatives” which requires that there should be no reassessment of whether an embedded derivative should be separated from the host contract after initial recognition, unless there have been changes to the contract. The adoption of IFRIC 9 had no impact on the Bank’s profit or loss or financial position.

**IFRS 8** – The IASB issued IFRS 8 “Operating Segments” in December 2006. This will replace IAS 14 “Segment Reporting” for accounting periods beginning on or after 1 January 2009. IFRS 8 requires segmental analysis reported by an entity to be based on information used by management. Management is currently assessing the impact of the adoption of IFRS 8.

**IAS 1** – on 6 September 2006, the IASB issued an amendment to IAS 1 which changes the way in which non-owner changes in equity are required to be presented to in IFRS but does not require that these be renamed in an entity’s financial statements. The amendment to IAS 1 is effective for periods beginning on or after 1 January 2009.

**IAS 23** – On March 2007 the IASB issued a revised IAS 23 “Borrowing Costs”. The main change is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalise borrowing costs as part of the cost of such asset. The Standard applies to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009.

**IAS 27** - In 2008 the Standard was amended as part of the second phase of the business combinations project. That phase of the project was undertaken jointly with the US Financial Accounting Standards Board (FASB). The amendments related, primarily, to accounting for non-controlling interests and the loss of control of a subsidiary. The boards concluded the second phase of the project by the IASB issuing the amended IAS 27 and the FASB issuing FASB Statement No. 160 Noncontrolling Interests in Financial Statements, along with, respectively, a revised IFRS 3 Business Combinations and FASB Statement No. 141 (revised 2007) Business Combinations. The amended Standard must be applied for annual periods beginning on or after 1 July 2009. Earlier application is permitted. However, an entity must not apply the amendments for annual periods beginning before 1 July 2009 unless it also applies IFRS 3 (as revised in 2008).

#### 4. NET INTEREST INCOME

	Year ended 31 December 2008	Year ended 31 December 2007
<b>Interest income comprises:</b>		
Interest income on financial assets recorded at amortized cost:		
- interest income on impaired financial assets	42,161	20,760
- interest income on unimpaired financial assets	<u>379</u>	<u>95</u>
<b>Total interest income</b>	<u>42,540</u>	<u>20,855</u>
Interest income on financial assets recorded at amortized cost comprises:		
Interest on loans to customers	42,161	20,355
Interest on due from banks	92	405
Interest on investments held-to-maturity	<u>-</u>	<u>-</u>
Total interest income on financial assets recorded at amortized cost	<u>42,253</u>	<u>20,760</u>
Interest income on investments available-for-sale	<u>287</u>	<u>95</u>
<b>Total Interest income</b>	<u>42,540</u>	<u>20,855</u>
<b>Interest expense comprises:</b>		
Interest on financial liabilities recorded at amortized cost	<u>12,544</u>	<u>6,643</u>
<b>Total interest expense</b>	<u>12,544</u>	<u>6,643</u>
Interest expense on financial liabilities recorded at amortized cost comprise:		
Interest on loans from shareholders and financial institutions	(11,167)	(6,177)
Interest on customer accounts	<u>(1,377)</u>	<u>(466)</u>
Total interest expense on financial liabilities recorded at amortized cost	<u>(12,544)</u>	<u>(6,643)</u>
<b>Net interest income before provision for impairment losses on interest bearing financial assets</b>	<u><u>29,996</u></u>	<u><u>14,212</u></u>

**5. ALLOWANCE FOR IMPAIRMENT LOSSES ON LOANS TO CUSTOMERS AND OTHER ASSETS**

The movements in allowance for impairment losses on interest bearing assets were as follows:

	2008	2007
<b>At the beginning of the year</b>	1,987	857
Additional provisions recognized	2,116	1,111
Recoveries of assets previously written off	13	19
Write off	<u>-</u>	<u>-</u>
<b>At the end of the year</b>	<u><u>4,116</u></u>	<u><u>1,987</u></u>

The movements in allowances for impairment losses on other assets were as follows:

	2008	2007
<b>At the beginning of the year</b>	-	-
Additional provisions recognized	<u>120</u>	<u>-</u>
<b>At the end of the year</b>	<u><u>120</u></u>	<u><u>-</u></u>

**6. NET GAIN ON FOREIGN EXCHANGE OPERATIONS**

Net gain on foreign exchange operations comprises:

	Year ended 31 December 2008	Year ended 31 December 2007
Dealing, net	394	131
Translation differences, net	<u>2</u>	<u>(77)</u>
<b>Total net gain on foreign exchange operations</b>	<u><u>396</u></u>	<u><u>54</u></u>

## 7. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	Year ended 31 December 2008	Year ended 31 December 2007
<b>Fee and commission income:</b>		
Cash operations	1,995	1,274
Settlements	606	133
Foreign exchange operations	99	44
Plastic cards operations	67	26
Other	17	13
<b>Total fee and commission income</b>	<b>2,784</b>	<b>1,490</b>
<b>Fee and commission expense:</b>		
Cash operations	(124)	(144)
Settlements	(32)	(12)
Plastic cards operations	(44)	(30)
Foreign exchange operations	-	(1)
<b>Total fee and commission expense</b>	<b>(200)</b>	<b>(187)</b>

## 8. OPERATING EXPENSES

Operating expenses comprise:

	Year ended 31 December 2008	Year ended 31 December 2007
Staff costs	8,519	4,428
Unified social tax	1,837	929
Advertising costs	1,148	449
Rental of premises	1,071	718
Printing and office supplies	1,005	576
Depreciation and amortization	947	664
Management services (Note 25)	729	904
Security	682	237
Repair and maintenance	607	332
Communication	514	324
Professional fees	200	105
Utilities	106	76
Taxes other than income tax	15	20
Other operating expenses	625	293
<b>Total operating expenses</b>	<b>18,005</b>	<b>10,055</b>

During the years ended 31 December 2008 and 2007 the Bank obtained management services from its shareholder LFS Financial Systems in accordance with a management services agreement, dated 14 September 2002, which included secondment of LFS Financial Systems' personnel, provision and maintenance of software system and general institutional support.

## 9. INCOME TAXES

The Bank provides for taxes based on the tax accounts maintained and prepared in accordance with the tax regulations of countries where the Bank operates, which may differ from IFRS.

The Bank is subject to certain permanent tax differences due to the non-tax deductibility of certain expenses and a tax free regime for certain income.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at 31 December 2008 and 2007 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Temporary differences as at 31 December 2008 and 2007 comprise:

	31 December 2008	31 December 2007
<b>Deductible temporary differences:</b>		
Other liabilities	-	196
<b>Total deductible temporary differences</b>	-	196
<b>Taxable temporary differences:</b>		
Property, equipment and intangible assets	81	(54)
Other liabilities	(26)	-
<b>Total taxable temporary differences</b>	55	(54)
Net deferred (deductible)/taxable temporary differences	(55)	142
<b>Net deferred tax (liability)/asset at the statutory tax rate (22%)</b>	<b>(12)</b>	<b>31</b>

Relationships between tax expenses and accounting profit for the years ended 31 December 2008 and 2007 are explained as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
Profit before income tax	13,413	4,812
Tax at the statutory tax rate (22%)	2,951	1,059
Tax effect of permanent differences:	7	154
<b>Income tax expense</b>	<b>2,958</b>	<b>1,213</b>
Current income tax expense	2,915	1,160
Change in the deferred tax assets	43	53
<b>Income tax expense</b>	<b>2,958</b>	<b>1,213</b>

The tax rate used for the 2008 and 2007 reconciliations above is the corporate tax rate of 22% payable by corporate entities in the Republic of Azerbaijan on taxable profits under tax law in that jurisdiction.

<b>Deferred income tax (liabilities)/assets</b>	<b>2008</b>	<b>2007</b>
<b>Beginning of the period</b>	31	84
Change in income tax asset/(liability) for the period charged to profit	<u>(43)</u>	<u>(53)</u>
<b>End of the period</b>	<u><u>(12)</u></u>	<u><u>31</u></u>

## 10. EARNINGS PER SHARE

	<b>Year ended 31 December 2008</b>	<b>Year ended 31 December 2007</b>
<b>Profit:</b>		
Net profit for the year	<u>10,455</u>	<u>3,599</u>
Weighted average number of ordinary shares for basic earnings per share	<u>15,844,262</u>	<u>9,837,225</u>
<b>Earnings per share basic and diluted, AZN</b>	<u><u>0.66</u></u>	<u><u>0.37</u></u>

## 11. CASH AND BALANCES WITH THE CENTRAL BANK OF THE REPUBLIC OF AZERBAIJAN

	<b>31 December 2008</b>	<b>31 December 2007</b>
Cash	8,291	4,700
Balances with the National Bank of Azerbaijan	<u>1,750</u>	<u>1,785</u>
<b>Total cash and balances with the National Bank of Azerbaijan</b>	<u><u>10,041</u></u>	<u><u>6,485</u></u>

The balances with the National Bank of Azerbaijan as at 31 December 2008 and 2007 include AZN 995 thousand and AZN 1,083 thousand, respectively, which represents the obligatory minimum reserve deposits with the National Bank of Azerbaijan. The Bank is required to maintain the reserve balance at the National Bank of Azerbaijan at all times.

Cash and cash equivalents for the purposes of the statement of cash flows comprise the following:

	<b>31 December 2008</b>	<b>31 December 2007</b>
Cash and balances with the National Bank of Azerbaijan	10,041	6,485
Due from banks in OECD countries (Note 29)	<u>2,821</u>	<u>1,551</u>
	12,862	8,036
Less minimum reserve deposits in local and foreign currency with the NBA	<u>(995)</u>	<u>(1,083)</u>
<b>Total cash and cash equivalents</b>	<u><u>11,867</u></u>	<u><u>6,953</u></u>

## 12. DUE FROM BANKS

Due from banks comprise:

	31 December 2008	31 December 2007
<b>Recorded as loans and receivables:</b>		
Correspondent accounts with other banks	7,314	1,728
Blocked deposit at bank	20	-
Loan to bank	-	508
	<u>7,334</u>	<u>2,236</u>
<b>Total due from banks</b>	<b><u>7,334</u></b>	<b><u>2,236</u></b>

As at 31 December 2008 the Bank had funds due from one bank, which individually exceeded 10% of the Bank's equity.

As at 31 December 2007 the Bank had funds due from one bank, which individually exceeded 10% of the Bank's equity.

As at 31 December 2008 and 2007 the maximum credit risk exposure on funds due from banks amounted to AZN 7,334 thousand and AZN 2,236 thousand, respectively.

## 13. LOANS TO CUSTOMERS

Loans to customers comprise:

	31 December 2008	31 December 2007
<b>Recorded as loans and receivables:</b>		
Loans to customers	167,785	95,964
Less: allowance for impairment losses (Note 5)	<u>(4,116)</u>	<u>(1,987)</u>
<b>Total loans to customers</b>	<b><u>163,669</u></b>	<b><u>93,977</u></b>

Movements in allowances for impairment losses for the years ended 31 December 2008 and 2007 are disclosed in Note 5.

The table below summarizes the amount of loans secured by type of collateral, rather than the fair value of the collateral itself:

	31 December 2008	31 December 2007
Loans collateralized by real estate	81,434	48,916
Loans collateralized by combined collateral (inventory and equipment)	76,288	36,917
Other collateral	9,632	9,051
Unsecured loans	<u>431</u>	<u>1,080</u>
	167,785	95,964
Less: allowance for impairment losses	<u>(4,116)</u>	<u>(1,987)</u>
<b>Total loans to customers</b>	<b><u>163,669</u></b>	<b><u>93,977</u></b>

	31 December 2008	31 December 2007
<b>Analysis by sector:</b>		
Trade	102,652	58,291
Services	20,218	9,079
Manufacturing	13,874	9,817
Retail lending	13,413	9,784
Agriculture	9,991	3,391
Communication	7,523	4,316
Construction	114	246
Other	-	1,040
	<u>167,785</u>	<u>95,964</u>
Less: allowance for impairment losses	<u>(4,116)</u>	<u>(1,987)</u>
<b>Total loans to customers</b>	<b><u>163,669</u></b>	<b><u>93,977</u></b>

Collaterals represented by combination of equipment and inventory are not registered by state authorities and bear higher risk than other collaterals.

All loans (100% of total portfolio) are granted to companies and individuals operating in the Republic of Azerbaijan, which represents significant geographical concentration in one region.

As at 31 December 2008 and 2007 a maximum credit risk exposure on loans to customers amounted to AZN 163,669 thousand and AZN 93,977 thousand, respectively.

As at 31 December 2008 and 2007 loans to customers included loans in amount of AZN 12,012 thousand and AZN 3,563 thousand, respectively, that were individually determined to be impaired. These amounts represent the sum of outstanding amounts of individually significant loans to borrowers, whose financial statements are insufficient to make judgment on the development of their business or business environment. None of these loans were overdue or had any arrears, either in payment of principal or interest. All of these loans are fully collateralized by marketable real estate or 100% guarantee of an "AA" rated bank (S&P, Fitch). As at 31 December 2008 such loans were collateralized by property with fair value of AZN 20,928 thousand and as at 31 December 2007 by property with fair value of AZN 3,049 thousand and guarantee from AA rated bank for AZN 845,300 thousand.

As at 31 December 2008, out of the Bank's total loans to customers portfolio of AZN 167,785 thousand, loans in amount of AZN 930 thousand had been in arrears for over 30 days. As at 31 December 2007, out of Bank's total loans to customers portfolio of AZN 95,964 thousand, loans in amount of AZN 48 thousand had been in arrears over 30 days.

As at 31 December 2008 and 2007 the bank had not had loans with interest rates less than market rates.

#### 14. INVESTMENTS AVAILABLE-FOR-SALE

Investments available-for-sale comprises:

	31 December 2008	31 December 2007
Debt securities	5,823	5,253
Equity securities	<u>40</u>	<u>40</u>
<b>Total investments available-for-sale</b>	<b><u>5,863</u></b>	<b><u>5,293</u></b>

	31 December 2008		31 December 2007	
	Nominal interest rate	Fair value	Nominal interest rate	Fair value
<b>Debt securities</b>				
<b>National Bank of Azerbaijan</b>				
NBA notes No. 50105019S	5.36 %	3,440	-	-
NBA notes No. 50105119S	5.29 %	1,751	-	-
NBA notes No. 50105219S	4.26 %	632	-	-
NBA notes No. 50100618S	-	-	11.15%	459
NBA notes No. 50100718S	-	-	11.28%	951
NBA notes No. 50100818S	-	-	6.80%	3,843
		<u>5,823</u>		<u>5,253</u>

	Ownership interest	31 December 2008	Ownership interest	31 December 2007
<b>Equity securities</b>				
Milli Card LLC	1%	<u>40</u>	1%	<u>40</u>
<b>Total investments available-for-sale</b>		<u>5,863</u>		<u>5,293</u>

#### 15. INVESTMENTS HELD TO MATURITY

	31 December 2008		31 December 2007	
	Nominal interest rate	Amount	Nominal interest rate	Amount
<i>NBA REPO Agreement</i>	2%	<u>125</u>	-	<u>-</u>
<b>Total investments held to maturity</b>		<u>125</u>		<u>-</u>

## 16. PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS

	Land, buildings and leasehold improvements	Furniture and fixtures	Computer equipment	Vehicles	Intangible assets	Total
<b>At initial cost</b>						
31 December 2006	1,118	1,112	338	80	88	2,736
Additions	1,865	417	292	34	36	2,644
Transfers	-	(83)	83	-	-	-
31 December 2007	2,983	1,446	713	114	124	5,380
Additions	1,154	879	383	124	935	3,475
Disposals	-	(3)	(10)	-	-	(13)
31 December 2008	4,137	2,322	1,086	238	1,059	8,842
<b>Accumulated depreciation</b>						
31 December 2006	536	388	154	33	29	1,140
Charge for the year	226	270	122	23	23	664
Transfers	-	(41)	41	-	-	-
31 December 2007	762	617	317	56	52	1,804
Charge for the year	276	403	191	47	30	947
Disposals	-	(3)	(10)	-	-	(13)
31 December 2008	1,038	1,017	498	103	82	2,738
<b>Net book value</b>						
31 December 2008	<u>3,099</u>	<u>1,305</u>	<u>588</u>	<u>135</u>	<u>977</u>	<u>6,104</u>
31 December 2007	<u>2,221</u>	<u>829</u>	<u>396</u>	<u>58</u>	<u>72</u>	<u>3,576</u>

As at 31 December 2008 and 2007 included in property, equipment and intangible assets were fully depreciated and amortized assets in the amount of AZN 782 thousands and AZN 184 thousands, respectively.

Intangible assets include software and licenses.

Intangible assets additions for the amount of AZN 935 thousand include banking and accounting software for the amount of AZN 817 thousand purchased from LFS Financial Systems, one of the shareholders of the Bank. The management and board of directors of the Bank consider this transaction to have been executed on an arms length basis.

## 17. OTHER ASSETS

Other assets comprise:

	31 December 2008	31 December 2007
<b>Other financial assets recorded as loans and receivables in accordance with IAS 39:</b>		
Settlements with money transfer system	122	51
Settlements with Plastic cards	95	-
Less allowance for impairment losses (Note 5)	(54)	-
<b>Other non-financial assets:</b>		
Prepaid Loan Origination Fee to EBRD and IFC for loans to be received	328	-
Prepayments on rent and other expenses	192	244
Prepayments on property, equipment and intangible assets	96	660
Collateral repossessed	66	83
Less allowance for impairment losses (Note 5)	(66)	-
<b>Total other assets</b>	<b>779</b>	<b>1,038</b>

Movements in allowances for impairment losses on other assets for the years ended 31 December 2008 and 2007 are disclosed in Note 5.

## 18. LOANS FROM SHAREHOLDERS

	31 December 2008	31 December 2007
Kreditanstalt für Wiederaufbau	11,910	3,674
Black Sea Trade and Development Bank	3,248	874
International Finance Corporation	2,491	1,561
European Bank for Reconstruction and Development	2,015	4,258
<b>Total loans from shareholders</b>	<b>19,664</b>	<b>10,367</b>

- On 6 October 2003 the Bank signed a loan agreement with European Bank for Reconstruction and Development to the amount of USD 5,000 thousand. The loan bears market interest per annum. Principal is to be repaid starting from 14 May 2008 in four equal semi-annual installments. Interest is paid on the same dates.
- On 6 July 2005 the Bank signed a loan agreement with International Finance Corporation to the amount of USD 3,000 thousand. The loan bears market interest per annum. Principal is to be repaid starting from 15 December 2006 in eight equal semi-annual installments. Interest is paid on the same dates.
- On 30 March 2006 the Bank signed a loan agreement with Kreditanstalt für Wiederaufbau to the amount of USD 5,000 thousand. The loan bears market interest per annum. Principal is to be repaid starting from 30 December 2007 in eight equal semi-annual installments. Interest is paid on the same dates.

- On 11 May 2007 the Bank signed a Supplier Finance Facility agreement with International Finance Corporation to the amount of USD 3,860 thousand. As at 31 December 2008 the bank received the first tranche for the amount USD 2,000 thousand. The loan bears market interest rate. Principal is to be repaid in 5 equal semi-annual installments by maturity, which is 15 June 2014. Interest is paid starting from 15 June 2008 in semi-annual installments.
- On 4 March 2008 the Bank signed a loan agreement with Black Sea Trade and Development Bank (registered in Greece) to the amount of USD 4,000 thousand. The loan bears market interest rate. Principal is to be repaid in nine approximately equal semi-annual installments by maturity, which is 4 March 2013. Interest is paid starting from 4 September 2008 in semi-annual installments.
- On 6 November 2008 the Bank signed a credit line agreement with Kreditanstalt für Wiederaufbau (registered in Germany) to the amount of USD 22,000 thousand. As at 31 December 2008 the bank received the first tranche for the amount USD 12,000 thousand. The loan bears market interest rate. Principal is to be repaid in six equal semi-annual installments by maturity, which is 30 September 2013. Interest is paid starting from 30 March 2009 in semi-annual installments.
- On 19 November 2008 the Bank signed a Syndicated loan agreement with European Bank for Reconstruction and Development to the amount of USD 28,000 thousand. As at 31 December 2008 no funds were drawn down under this agreement. The loan bears market interest rate. USD 8,000 thousand principal is to be repaid on 9 June 2010 and USD 20,000 thousand is to be repaid in three equal semi-annual installments starting from 9 December 2010 by maturity, which is 9 December 2011. Interest is paid starting from 9 June 2009 in semi-annual installments.

As at 31 December 2008 and 2007 accrued interest expense included in loans from shareholders amounted to AZN 153 thousand and AZN 81 thousand, respectively.

The Bank is obligated to comply with financial covenants in relation to debt securities issued disclosed above. These covenants include stipulated ratios, debt to equity ratios and various other financial performance ratios. The Bank has not breached any of these covenants during the years ended 31 December 2008 and 2007.

## 19. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	31 December 2008	31 December 2007
Developing World Markets Securitizations S.A. acting on behalf of its Compartment MFBA BOND I	20,486	9,780
Dexia Micro-Credit Fund	9,831	4,295
Blueorchard Loans for Development S.A.	9,667	10,193
Deutsche Bank Aktiengesellschaft	8,189	8,610
Global Microfinance Facility	8,143	2,578
Triodos International Fund Management	5,978	5,461
Pettelaar Effectenbewaarbedrijf N.V.	5,909	4,224
Bank im Bistum Essen	5,691	-
Swiss Investment Fund for Emerging Markets	4,897	3,370
VDK Spaarbank N.V.	4,810	2,554
MINLAM Microfinance Offshore Master Fund LP	4,097	-
Impulse Microfinance Investment Fund	4,050	1,492
Global Commercial Microfinance Consortium, Ltd.	3,191	3,364
Organization of the Petroleum Exporting Countries Fund for International Development	3,122	4,238
Oikocredit Ecumenical Development Cooperative Society U.A.	3,065	1,772
Triple Jump B.V.	2,476	2,609
Dual return Fund S.I.C.A.V.	2,462	1,273
Microfinance Loan Obligations S.A.	2,460	2,597
ResponsAbility SICAV (Luxembourg)	2,090	2,204
Asian Development Bank	2,087	3,045
EMF Microfinance AG	1,216	-
Developing World Markets Securitization S.A.	1,604	1,690
Vantage Mutual Fund	256	254
Finethic Microfinance Fund	801	-
	<hr/>	<hr/>
<b>Total due to banks and other financial institutions</b>	<b>116,578</b>	<b>75,603</b>

- On 24 January 2007 the Bank signed a loan agreement with ASN-NOVIB Fonds duly represented by its agent Triple Jump B.V., to the amount of USD 3,000 thousand. The loan bears market interest rate per annum. Principal is to be repaid in two installments on 28 February 2010 and 31 August 2010. Interest is paid starting from 31 August 2007 in six installments.
- On 26 February 2007 the Bank signed a loan agreement with Dexia Micro Credit Fund (registered in Luxembourg) to the amount of USD 2,000 thousand. The loan bears market interest rate per annum. Principal is to be repaid in two installments on 26 February 2009 and 26 February 2010, which is the maturity date. Interest is paid starting from 26 August 2007 in six semi-annual installments.
- On 15 March 2007 the Bank signed a loan agreement with Microfinance Loan Obligations S.A. acting on behalf of its Compartment Local Currency-2 (registered in Luxembourg) to the amount of USD 3,000 thousand. The loan bears market interest rate per annum. Principal is to be repaid on maturity, which is 1 April 2011. Interest is paid starting from 3 October 2007 in eight installments.
- On 20 March 2007 the Bank signed a loan agreement with the OPEC Fund for International Development (registered in Austria) to the amount of USD 5,000 thousand. The loan bears market interest rate per annum. Principal is to be repaid in nine approximately equal semi-annual installments by maturity, which is 1 June 2012. Interest is paid starting from 1 December 2007 in semi-annual installments.

- On 10 April 2007 the Bank signed a loan agreement with Stitching Triodos-Doen and Triodos Custody B.V. (custodian of Triodos Fair Share Fund) to the amount of USD 2,000 thousand. The loan bears market interest rate per annum. Principal is to be repaid on maturity which is 1 May 2010. Interest is paid semi-annually starting from 1 July 2007.
- On 23 April 2007 the Bank signed a loan agreement with VDK Spaarbank N.V. (registered in Belgium) to the amount of USD 3,000 thousand. The loan bears market interest rate per annum. Principal is to be repaid on maturity, which is 11 May 2010. Interest is paid starting from 11 November 2007 in six installments.
- On 23 April 2007 the Bank signed a loan agreement with Impulse Microfinance Investment Fund to the amount of USD 500 thousand. The loan bears market interest rate. Principal is to be repaid by maturity, which is 1 May 2010. Interest is paid starting from 11 November 2007 in semi-annual installments.
- On 31 May 2007 the Bank signed a loan agreement with BlueOrchard Loans for Development S.A. (registered in Luxembourg) to the amount of USD 8,000 thousand. The loan bears market interest rate per annum. Principal is to be repaid on maturity which is 1 June 2012. Interest is paid quarterly starting from 1 September 2007.
- On 2 July 2007 the Bank signed a loan agreement with the Deutsche Bank Aktiengesellschaft (registered in Germany) to the amount of USD equivalent of 7,400 thousand euro. The loan bears market interest rate per annum. Principal is to be repaid on maturity, which is 31 December 2014. Interest is paid starting from 31 August 2007 quarterly. In the event of bankruptcy or liquidation of the Bank, repayment of this debt is subordinated to the repayments of the Bank's liabilities to all other creditors.
- On 29 August 2007 the Bank signed the term loan facility agreement with DWM Securitizations S.A. (registered in Luxembourg) acting on behalf of its Compartment MFBA BOND I to the amount of USD 11,400 thousand. During 2008 year the Bank received the second tranche for the amount of USD 13,600 thousand. The loan bears market interest rate per annum. Principal is to be repaid in four installments starting from 24 February 2011 by the maturity date which is 28 August 2012. Interest is paid in ten installments starting from 28 February 2008.
- On 2 October 2007 the Bank signed a loan agreement with Triodos Custody B.V. (custodian of Triodos Fair Share Fund) (registered in the Netherlands) to the amount of USD 2,500 thousand. The loan bears market interest rate per annum. Principal is to be repaid on maturity which is 1 November 2010. Interest is paid semi-annually starting from 1 January 2008.
- On 13 November 2007 the Bank signed a loan agreement with Pettelaar Effectenbewaarbedrijf N.V. to the amount equal to USD 5,000 thousand in Azerbaijan manat. The loan bears market interest rate per annum. Principal is to be repaid on maturity which is 6 December 2009. Interest is paid quarterly starting from the last business day of January 2008 (30 January 2008).
- On 30 November 2007 the Bank signed a loan agreement with the Swiss Investment Fund for Emerging Markets on behalf of the State Secretariat for Economic Affairs of Switzerland (registered in Switzerland) to the amount of a credit line limited to USD 6,000 thousand. As at 31 December 2007 the Bank had used USD 4,000 thousand of the above limit. During 2008 year the second tranche for the amount of USD 2,000 thousand was also received by the Bank. The loan bears market interest rate per annum. Principal is to be repaid in eight equal installments starting from 7 January 2010 by maturity, which is 7 January 2014. Interest is paid starting from 31 March 2008 semi-annually.
- On 8 February 2008 the Bank signed a loan agreement with the Oikocredit Ecumenical Development Cooperative Society U.A. (registered in Netherlands) to the amount of USD 2,500 thousand. The loan bears market interest rate. Principal is to be repaid in seven approximately equal semi-annual instalments by maturity, which is 27 February 2012. Interest is paid starting from 27 August 2008 in semi-annual instalments.

- On 11 February 2008 the Bank signed a loan agreement with the Dexia Micro Credit Fund (registered in Luxembourg) to the amount of USD 5,000 thousand. The loan bears market interest rate. Principal is to be repaid in two equal annual instalments by maturity, which is 11 February 2011. Interest is paid starting from 11 August 2008 in semi-annual instalments.
- On 24 April 2008 the Bank signed a loan agreement with Global Microfinance Facility to the amount of USD 10,000 thousand. This loan agreement amends the loan agreement dated 9 October 2006, under which the Bank received the loan to the amount USD 3,000 thousand. The loan bears market interest rate. Principal is to be repaid by maturity, which is 07 April 2014. Interest is paid starting from 30 July 2008 in quarterly installments.
- On 15 May 2008 the Bank signed a loan agreement with the Dexia Micro Credit Fund (registered in Luxembourg) to the amount of USD 2,000 thousand. The loan bears market interest rate. Principal is to be repaid in two equal annual instalments by maturity, which is 16 May 2011. Interest is paid starting from 15 November 2008 in semi-annual instalments.
- On 29 May 2008 the Bank signed a loan agreement with Pettelaar Effectenbewaarbeprijf N.V. to the amount of USD 2,000 thousand. The loan bears market interest rate. Principal is to be repaid by maturity, which is 15 June 2010. Interest is paid starting from 31 July 2008 in quarterly installments.
- On 27 June 2008 the Bank signed a loan agreement with the VDK Spaarbank N.V. (registered in Belgium) to the amount of USD 3,000 thousand. The loan bears market interest rate. Principal is to be repaid on maturity, which is 24 June 2012. Interest is paid starting from 24 December 2008 in semi-annual instalments.
- On 30 June 2008 the Bank signed a loan agreement with the Finethic Microfinance Fund to the amount of USD 1,000 thousand. The loan bears market interest rate. Principal is to be repaid on maturity, which is 2 July 2011. Interest is paid starting from 2 January 2009 in semi-annual instalments.
- On 2 July 2008 the Bank signed a loan agreement with the Dual Return Fund S.I.C.A.V. to the amount of USD 1,500 thousand. The loan bears market interest rate. Principal is to be repaid on maturity, which is 8 July 2011. Interest is paid starting from 8 January 2009 in semi-annual instalments.
- On 15 August 2008 the Bank signed a loan agreement with the MINLAM Microfinance Offshore Master Fund LP to the amount of USD 5,000 thousand in AZN equivalent. The loan bears market interest rate. Principal is to be repaid on maturity, which is 26 August 2011. Interest is paid starting from 15 November 2008 in annual instalments.
- On 20 August 2008 the Bank signed a loan agreement with the Triodos Custody B.V. (custodian of Triodos Fair Share Fund) to the amount of USD 1,000 thousand. The loan bears market interest rate. Principal is to be repaid on maturity, which is 1 September 2010. Interest is paid starting from 1 January 2009 in semi-annual instalments.
- On 21 August 2008 the Bank signed a loan agreement with the Impulse Microfinance Investment Fund to the amount of USD 1,500 thousand. The loan bears market interest rate. Principal is to be repaid on maturity, which is 29 August 2012. Interest is paid starting from 29 February 2009 in semi-annual instalments.
- On 25 September 2008 the Bank signed a loan agreement with the Bank im Bistum Essen to the amount of USD 7,000 thousand. The loan bears market interest rate. Principal is to be repaid on maturity, which is 29 September 2012. Interest is paid starting from 29 March 2008 in semi-annual instalments.

- On 17 November 2008 the Bank amended the loan agreement with Impulse Microfinance Investment Fund dated 17 November 2005. The loan amount was increased from USD 1,250 thousand to USD 3,000 thousand. The maturity of principal, which is still to be paid in one instalment, changed from 17 November 2008 to 16 November 2012. Interest payment frequency did not change and is paid in semi-annual installments. The loan bears market interest rate.
- On 17 November 2008 the Bank signed a loan agreement with the EMF Microfinance AGmvK to the amount of USD 1,500 thousand. The loan bears market interest rate. Principal is to be repaid on maturity, which is 17 November 2010. Interest is paid starting from 17 May 2009 in semi-annual instalments.

As at 31 December 2008 and 2007 accrued interest expense included in due to banks and other financial institutions amounted to AZN 2,205 thousand and AZN 1,094 thousand, respectively.

The Bank is obligated to comply with financial covenants in relation to debt securities issued disclosed above. These covenants include stipulated ratios, debt to equity ratios and various other financial performance ratios. The Bank has not breached any of these covenants during the years ended 31 December 2008 and 2007.

These liabilities are measured at amortized cost.

## 20. CUSTOMER ACCOUNTS

Customer accounts comprise:

	31 December 2008	31 December 2007
<b>Recorded at amortized cost:</b>		
Time deposits	15,916	8,557
Repayable on demand	4,838	3,270
Blocked accounts	1,098	307
<b>Total customer accounts</b>	<b><u>21,852</u></b>	<b><u>12,134</u></b>
	31 December 2008	31 December 2007
<b>Analysis by sector:</b>		
Individuals	15,587	9,909
Insurance	3,995	912
Trade	1,172	1,313
Other	1,098	-
<b>Total customer accounts</b>	<b><u>21,852</u></b>	<b><u>12,134</u></b>

These liabilities are measured at amortized cost.

## 21. OTHER LIABILITIES

Other liabilities comprise:

	31 December 2008	31 December 2007
<b>Other financial liabilities:</b>		
Accrued staff cost	409	143
Settlements with money transfer system	180	29
Accrued expenses	<u>167</u>	<u>76</u>
<b>Total other liabilities</b>	<u><u>756</u></u>	<u><u>248</u></u>

## 22. SHARE CAPITAL

As of 31 December 2008 and 2007 the authorized, issued and paid-in share capital consisted of 20,000,000 and 11,000,000 ordinary shares with par value of AZN 1 each.

The below table provides a reconciliation of the number of shares authorized, issued and paid-in as of 31 December 2008 and 2007:

	Ordinary shares
31 December 2006	6,713,000
Issue of shares	<u>4,287,000</u>
31 December 2007	11,000,000
Issue of shares	<u>9,000,000</u>
31 December 2008	<u><u>20,000,000</u></u>

AZN 9,000 thousand issue of shares was registered by Azerbaijan State Securities Committee in June 2008.

## 23. COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Bank is a party to financial instruments with off-balance sheet risk in order to meet the needs of its customers. These instruments, involving varying degrees of credit risk, are not reflected in the balance sheet.

The Bank's maximum exposure to credit loss under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

The Bank uses the same credit control and management policies in undertaking off-balance sheet commitments as it does for on-balance operations.

As at 31 December 2008 and 2007 the nominal or contract amounts were:

	31 December 2008	31 December 2007
Guarantees issued and similar commitments	<u>113</u>	<u>269</u>
<b>Total contingent liabilities and credit commitments</b>	<u><u>113</u></u>	<u><u>269</u></u>

***Operating lease and capital commitment*** – The Bank does not have any non-cancellable operating leases and capital commitments as at 31 December 2008 and 2007.

***Legal proceedings*** – From time to time and in the normal course of business, claims against the Bank are received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these financial statements.

***Taxation*** – Provisions of the tax legislation of the Republic of Azerbaijan are sometimes inconsistent and may have more than one interpretation, which allows the Azerbaijani tax authorities to take decisions based on their own arbitrary interpretation of these provisions. In practice, the Azerbaijani tax authorities often interpret the tax legislation not in favor of the taxpayers, who have to resort to court proceeding to defend their position against the tax authorities. It should be noted that the Azerbaijani tax authorities can use the clarifications issued by the judicial bodies that have introduced the concept of “unjustified tax benefit”, “primary commercial goal of transaction” and the criteria of “commercial purpose (substance) of transaction”. Such uncertainty could, in particular, be attributed to tax treatment of financial instruments/derivatives and determination of market price of transactions for transfer pricing purposes. It could also lead to temporary taxable differences occurred due to loan impairment provisions and income tax liabilities being treated by the tax authorities as understatement of the tax base. The management of the Bank is confident that applicable taxes have all been accrued and, consequently, creation of respective provisions is not required.

Generally, taxpayers are subject to tax audits with respect to three calendar years preceding the year of the audit. However, completed audits do not exclude the possibility of subsequent additional tax audits performed by upper-level tax inspectorates reviewing the results of tax audits of their subordinate tax inspectorates. Also according to the clarification of the Country Constitutional Court the statute of limitation for tax liabilities may be extended beyond the three year term set forth in the tax legislation, if a court determines that the taxpayers has obstructed or hindered a tax inspection.

***Operating environment*** – The Bank’s principal business activities are within the Republic of Azerbaijan. Laws and regulations affecting the business environment in the Republic of Azerbaijan are subject to rapid changes and the Bank’s assets and operations could be at risk due to negative changes in the political and business environment.

***Specific volatility in global and Azerbaijan’s financial markets*** – In recent months a number of major economies around the world have experienced volatile capital and credit markets. A number of major global financial institutions have been placed into bankruptcy, taken over by other financial institutions and/or supported by government funding. As a consequence of the recent market turmoil in capital and credit markets both globally and in Azerbaijan, notwithstanding any potential economic stabilization measures that may be put into place by the Government of Azerbaijan, there exists economic uncertainties surrounding the continual availability, and cost, of credit both for the Bank and its counterparties, the potential for economic uncertainties to continue in the foreseeable future and, as a consequence, the potential that assets may not be recovered at their carrying amount in the regular course of business, and a corresponding impact on the Bank’s profitability.

***Recoverability of financial assets*** – As a result of recent economic turmoil in capital and credit markets globally, and the consequential economic uncertainties existing as at balance sheet date, there exists the potential that assets may not be recovered at their carrying amount in the regular course of business.

As at year end, the Bank has loans to customers amounting to AZN 163,669 thousand (2007: AZN 93,977 thousand). The recoverability of these loans to customers depends to a certain extent on the efficacy of the fiscal measures and other measures and other actions, beyond the Bank’s control, undertaken within various countries to achieve economic stability and recovery. The recoverability of the Bank’s loans to customers is determined based on conditions prevailing and information available as at balance sheet date. It is the management’s opinion that no additional provision on loans to customers is needed at present, based on prevailing conditions and available information.

## 24. SUBSEQUENT EVENTS

According to the loan agreement that the Bank signed with Kreditanstalt für Wiederaufbau on 6 November 2008, the Bank received the 2<sup>nd</sup> tranche of this loan to the amount of USD 10,000 thousand on 12 January 2009.

According to the loan agreement that the Bank signed with European Bank for Reconstruction and Development on 19 November 2008, the Bank received the 1<sup>st</sup> tranche of this loan to the amount of USD 14,000 thousand on 10 March 2009. The loan bears market interest rate. For this 1<sup>st</sup> tranche USD 4,000 thousand principal is to be repaid on 9 June 2010 and USD 10,000 thousand is to be repaid in three equal semi-annual installments starting from 9 December 2010 by maturity, which is 9 December 2011. Interest is paid starting from 9 June 2009 in semi-annual installments

On 12 March 2009 the Bank signed a loan agreement with the OPEC Fund for International Development to the amount of USD 5,000 thousand. The loan bears market interest rate. Principal is to be repaid in three equal semi-annual installments starting from the 2<sup>nd</sup> anniversary of the loan disbursement. Interest is to be paid starting from 6 months after the loan disbursement in semi-annual installments.

At its meeting dated 3 March 2009 the General Assembly of Shareholders of the Bank decided not to pay dividends from profits for 2008 and earlier years.

On 14 January 2009 the Bank opened a new branch in the town of Jalilabad, Azerbaijan, and on 29 March 2009 the Bank opened another new branch in the town of Salyan, Azerbaijan.

On 1 April 2009 the Bank closed its Airport branch due to the relocation of the market located near Baku Airport.

As the result of the Referendum held on 18 March 2009 in respect of amendments and supplements to the Constitution of the Republic of Azerbaijan the word National in the title of the National Bank of the Republic of Azerbaijan will be replaced with the word "Central".

## 25. TRANSACTIONS WITH RELATED PARTIES

Related parties or transactions with related parties, as defined by IAS 24 "Related party disclosures", represent:

- (a) Parties that directly, or indirectly through one or more intermediaries: control, or are controlled by, or are under common control with, the Bank (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Bank that gives them significant influence over the Bank; and that have joint control over the Bank;
- (b) Associates – enterprises on which the Bank has significant influence and which is neither a subsidiary nor a joint venture of the investor;
- (c) Joint ventures in which the Bank is a venturer;
- (d) Members of key management personnel of the Bank or its parent;
- (e) Close members of the family of any individuals referred to in (a) or (d);
- (f) Parties that are entities controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e);
- (g) Post-employment benefit plans for the benefit of employees of the Bank, or of any entity that is a related party of the Bank.

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. Details of transactions between the Bank and other related parties are disclosed below:

	Note	31 December 2008		31 December 2007	
		Related party balances	Total category as per financial statements caption	Related party balances	Total category as per financial statements caption
Loans to customers, net	13	175	163,669	40	93,977
- <i>key management</i>		175		40	
Property, equipment and intangible assets	16	817	6,104	-	3,576
- <i>shareholders</i>		817		-	
Other Assets	17	328	779	-	1,038
- <i>shareholders</i>		328		-	
Loans from shareholders	18	19,664	19,664	10,367	10,367
- <i>shareholders</i>		19,664		10,367	
Customer accounts	20	600	21,852	302	12,134
- <i>key management</i>		600		302	

The remuneration of directors and other members of key management were as follows:

	31 December 2008		31 December 2007	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
<b>Key management personnel compensation:</b>				
Local staff	367	8,519	218	4,428
LFS (payment for Management Services Contract)	729	729	904	904

Included in the income statement for the years ended 31 December 2008 and 2007 are the following amounts which arose due to transactions with related parties:

	Note	Year ended 31 December 2008		Year ended 31 December 2007	
		Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Interest income	4	18	42,540	2	20,855
- <i>key management</i>		18		2	
Interest expense	4	1,005	12,544	1,203	6,643
- <i>shareholders</i>		985		1,185	
- <i>key management</i>		20		18	

## 26. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale. The estimates presented herein are not necessarily indicative of the amounts the Bank could realize in a market exchange from the sale of its full holdings of a particular instrument.

The fair value of financial assets and liabilities compared with the corresponding carrying amount in the balance sheet of the Bank is presented below:

	31 December 2008		31 December 2007	
	Carrying value	Fair value	Carrying value	Fair value
Cash and balances with the NBA	10,041	10,041	6,485	6,485
Due from banks	7,334	7,334	2,236	2,236
Investment available-for-sale	5,863	5,863	5,293	5,293
Loans to customers	163,669	163,669	93,977	93,977
Investment held to maturity	125	125	-	-
Other financial assets	163	163	51	51
Loans from shareholders	19,664	19,664	10,367	10,367
Due to banks and other financial institutions	116,578	116,578	75,603	75,603
Customer accounts	21,852	21,852	12,134	12,134
Other financial liabilities	756	756	248	248

The fair value of loans to customers can not be measured reliably as it is not practicable to obtain market information or apply any other valuation techniques on such instruments.

## 27. REGULATORY MATTERS

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total (12%) and tier 1 capital (6%) to risk weighted assets.

The ratio was calculated according to the principles employed by the Basle Committee by applying the following risk estimates to the assets and off-balance sheet commitments net of allowances for impairment losses.

As at 31 December 2008 the Bank's total capital amount for Capital Adequacy purposes was AZN 43,584 thousand and tier 1 capital amount was AZN 33,299 thousand with ratio of 24,56 % and 18.76 %, respectively.

As at 31 December 2007 the Bank's total capital amount for Capital Adequacy purposes was AZN 20,726 thousand and tier 1 capital amount was AZN 13,844 thousand with ratio of 20.36 % and 13.60 %, respectively.

In addition, the Bank has to maintain a statutory capital adequacy ratio based on the National Bank of Azerbaijan requirements. During the years ended 31 December 2008 and 2007 the Bank was in compliance with the minimum capital requirements imposed by the NBA.

## 28. CAPITAL RISK MANAGEMENT

The Bank manages its capital to ensure that the Bank will be able to continue as a going concern while maximizing the return to stakeholders through the optimization of the debt and equity balance.

The capital structure of the Bank consists of debt and equity, comprising issued capital and retained earnings as disclosed in statement of changes in equity.

The Management Board reviews the capital structure on a semi-annual basis. As a part of this review, the Board considers the cost of capital and the risks associated with each class of capital. Based on recommendations of the Board, the Bank balances its overall capital structure through the payment of dividends, new share issues as well as the issue of new debt or the redemption of existing debt.

The Bank's overall capital risk management policy remains unchanged from 2007.

## 29. RISK MANAGEMENT POLICIES

Management of risk is fundamental to the Bank's banking business and is an essential element of the Bank's operations. The main risks inherent to the Bank's operations are those related to:

- Credit exposures
- Liquidity risk
- Market risk

The Bank recognizes that it is essential to have efficient and effective risk management processes in place. To enable this, the Bank has established a risk management framework, whose main purpose is to protect the Bank from risk and allow it to achieve its performance objectives. Through the risk management framework, the Bank manages the following risks:

### *Credit risk*

The Bank is exposed to credit risk which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

Risk management and monitoring is performed within set limits of authority, by the Credit Committees and the Bank's Management Board. Before any application is made by the Credit Committee, all recommendations on credit processes (borrower's limits approved, or amendments made to loan agreements, etc.) are reviewed and approved by Credit Management Department. Daily risk management is performed by the Head of Credit Department and Branch Management.

### Credit Divisions.

The Bank structures the level of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry (and geographical) segments. Limits on the level of credit risk by a borrower and a product (by industry sector, by region) are approved monthly by the Management Board. The exposure to any one borrower including banks and brokers is further restricted by sub-limits covering on and off-balance sheet exposures which are set by the Credit Committee. Actual exposures against limits are monitored daily.

Where appropriate, and in the case of most loans, the Bank obtains collateral and corporate and personal guarantees. Such risks are monitored on a continuous basis and subject to annual or more frequent reviews.

Commitments to extend credit represent unused portions of credit in the form of loans, guarantees or letters of credit. The credit risk on off-balance sheet financial instruments is defined as the probability of losses due to the inability of the counterparty to comply with the contractual terms and conditions. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of the loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank applies the same credit policy to the contingent liabilities as it does to the balance sheet financial instruments, i.e. the one based on the procedures for approving the grant of loans, using limits to mitigate the risk and current monitoring. The Bank monitors the term to maturity of off balance sheet contingencies because longer term commitments generally have a greater degree of credit risk than short-term commitments.

### **Maximum Exposure**

The Bank's maximum exposure to credit risk varies significantly and is dependant on both individual risks and general market economy risks.

The following table presents the maximum exposure to credit risk of balance sheet and off balance sheet financial assets. For financial assets in the balance sheet, the maximum exposure is equal to the carrying amount of those assets prior to any offset or collateral. For financial guarantees and other off balance sheet assets, the maximum exposure to credit risk is the maximum amount the Bank would have to pay if the guarantee was called on or in the case of commitments, if the loan amount was called on.

As at 31 December 2008:

				31 December 2008	
	Maximum exposure	Offset	Net exposure after offset	Collateral Pledged	Net exposure after offset and collateral
Loans and advances to banks	7,334	-	7,334	-	7,334
Loans to customers	163,669	755	162,914	181,805	-
Investments available-for-sale	5,863	-	5,863	-	5,863
Investments held to maturity	125	-	125	-	125
Other financial assets	163	-	163	-	163

As at 31 December 2007:

				31 December 2007	
	Maximum exposure	Offset	Net exposure after offset	Collateral Pledged	Net exposure after offset and collateral
Loans and advances to banks	2,236	-	2,236	-	2,236
Loans to customers	93,977	180	93,797	94,196	-
Investments available-for-sale	5,293	-	5,293	-	5,293
Investments held to maturity	-	-	-	-	-
Other financial assets	51	-	51	-	51

Financial assets are graded according to the current credit rating they have been issued by a “Fitch Ratings” global rating agency. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade.

The following table details the credit ratings of financial assets held by the Bank as at 31 December 2008:

	AAA	AA	A	BBB	<BBB	Not rated	Total at 31 December 2008
Loans and advances to banks	-	2,821	-	16	256	4,241	7,334
Loans to customers	-	-	-	-	-	163,669	163,669
Investments available-for-sale	-	-	-	-	5,823	40	5,863
Investments held to maturity	-	-	-	-	-	125	125
Other financial assets	-	-	-	-	-	163	163

As at 31 December 2007:

	AAA	AA	A	BBB	<BBB	Not rated	Total at 31 December 2008 Total
Loans and advances to banks	-	1,547	-	-	25	664	2,236
Loans to customers	-	-	-	-	-	93,977	93,977
Investments available-for-sale	-	-	-	-	5,253	40	5,293
Other financial assets	-	-	-	-	-	51	51

The banking industry is generally exposed to credit risk through its loans to customers and inter bank deposits. With regard to the loans to customers this risk exposure is concentrated within the Country. The exposure is monitored on a regular basis to ensure that the credit limits and credit worthiness guidelines established by the Bank's risk management policy are not breached.

The following table details the carrying value of assets that are impaired and the ageing of those that are past due but not impaired. The amount of AZN 159,807 thousand of loans to customers that have been impaired as of 31 December 2008, and AZN 92,090 thousand as of 31 December 2007, represents loans which were provisioned for impairment based on a collective assessment of financial assets and macro-economic risk. Loans with overdue payments over 30 days included above consisted of AZN 930 thousand as of 31 December 2008 and AZN 48 thousand as of 31 December 2007.

As at 31 December 2008:

	Neither past 0-3 months due nor impaired	Financial assets past due but not impaired			Financial assets that have been impaired	Total at 31 December 2008
		3-6 months	6 months to 1 year	Greater than one year		
Loans and advances to banks	7,334	-	-	-	-	7,334
Loans to customers	3,862	-	-	-	159,807	163,669
Investments available-for-sale	5,863	-	-	-	-	5,863
Investments held to maturity	125	-	-	-	-	125
Other financial assets	163	-	-	-	-	163

As at 31 December 2007:

	Neither past 0-3 months due nor impaired	Financial assets past due but not impaired			Financial assets that have been Impaired	Total at 31 December 2007
		3-6 months	6 months to 1 year	Greater than one year		
Loans and advances to banks	2,236	-	-	-	-	2,236
Loans to customers	1,887	-	-	-	92,090	93,977
Investments available-for-sale	5,293	-	-	-	-	5,293
Other financial assets	51	-	-	-	-	51

### ***Geographical concentration***

The Assets and Liabilities Management Committee ("ALCO") exercises control over the risk in the legislation and regulatory arena and assesses its influence on the Bank's activity. This approach allows the Bank to minimize potential losses from the investment climate fluctuations in the Country.

The geographical concentration of assets and liabilities is set out below:

	Azerbaijan	Other non-OECD countries	OECD countries	31 December 2008 Total
<b>FINANCIAL ASSETS</b>				
Cash and balances with the NBA	10,041	-	-	10,041
Due from banks	4,163	350	2,821	7,334
Loans to customers	163,669	-	-	163,669
Investments available-for-sale	5,863	-	-	5,863
Investments held to maturity	125	-	-	125
Other financial assets	102	11	50	163
<b>TOTAL FINANCIAL ASSETS</b>	<b>183,963</b>	<b>361</b>	<b>2,871</b>	<b>187,195</b>
<b>FINANCIAL LIABILITIES</b>				
Loans from shareholders	-	-	19,664	19,664
Due to banks and other financial institutions	2	17,518	99,058	116,578
Customer accounts	21,852	-	-	21,852
Other financial liabilities	589	167	-	756
<b>TOTAL FINANCIAL LIABILITIES</b>	<b>22,443</b>	<b>17,685</b>	<b>118,722</b>	<b>158,850</b>
<b>NET POSITION</b>	<b>161,520</b>	<b>(17,324)</b>	<b>(115,851)</b>	
	Azerbaijan	Other non-OECD countries	OECD countries	31 December 2007 Total
<b>FINANCIAL ASSETS</b>				
Cash and balances with the NBA	6,485	-	-	6,485
Due from banks	594	91	1,551	2,236
Loans to customers	93,977	-	-	93,977
Investments available-for-sale	5,293	-	-	5,293
Other financial assets	-	-	51	51
<b>TOTAL FINANCIAL ASSETS</b>	<b>106,349</b>	<b>91</b>	<b>1,602</b>	<b>108,042</b>
<b>FINANCIAL LIABILITIES</b>				
Loans from shareholders	-	-	10,367	10,367
Due to banks and other financial institutions	-	8,987	66,616	75,603
Customer accounts	12,134	-	-	12,134
Other financial liabilities	244	-	4	248
<b>TOTAL FINANCIAL LIABILITIES</b>	<b>12,378</b>	<b>8,987</b>	<b>76,987</b>	<b>98,352</b>
<b>NET POSITION</b>	<b>93,971</b>	<b>(8,896)</b>	<b>(75,385)</b>	

### *Liquidity risk*

Liquidity risk refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due.

The ALCO controls these types of risks by means of maturity analysis, determining the Bank's strategy for the next financial period. Current liquidity is managed by the Treasury Department, which deals in the money markets for current liquidity support and cash flow optimization.

In order to manage liquidity risk, the Bank performs daily monitoring of future expected cash flows on clients' and banking operations, which is a part of assets/liabilities management process. The Management Board sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level on interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

An analysis of the liquidity and interest rate risks is presented in the following table. The presentation below is based upon the information provided internally to key management personnel of the entity.

	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2008 Total
<b>FINANCIAL ASSETS</b>							
Due from banks	4,002	-	-	-	-	-	4,002
Loans to customers	11,802	24,163	80,215	46,463	1,026	-	163,669
Investments available-for-sale	5,823	-	-	-	-	-	5,823
Investments held to maturity	125	-	-	-	-	-	125
<b>Total interest bearing financial assets</b>	<b>21,752</b>	<b>24,163</b>	<b>80,215</b>	<b>46,463</b>	<b>1,026</b>	<b>-</b>	<b>173,619</b>
Cash and balances with the National Bank of Azerbaijan	10,041	-	-	-	-	-	10,041
Due from banks	3,312	-	-	-	-	20	3,332
Investments available-for-sale	40	-	-	-	-	-	40
Other financial assets	163	-	-	-	-	-	163
<b>Total financial assets</b>	<b>35,308</b>	<b>24,163</b>	<b>80,215</b>	<b>46,463</b>	<b>1,026</b>	<b>20</b>	<b>187,195</b>
<b>FINANCIAL LIABILITIES</b>							
Loans from shareholders	-	422	3,974	14,960	308	-	19,664
Due to banks and other financial institutions	-	1,630	10,174	88,187	16,587	-	116,578
Customer accounts	2,134	1,351	10,181	3,348	-	-	17,014
<b>Total interest bearing financial liabilities</b>	<b>2,134</b>	<b>3,403</b>	<b>24,329</b>	<b>106,495</b>	<b>16,895</b>	<b>-</b>	<b>153,256</b>
Customer accounts	4,838	-	-	-	-	-	4,838
Other financial liabilities	756	-	-	-	-	-	756
<b>Total financial liabilities</b>	<b>7,728</b>	<b>3,403</b>	<b>24,329</b>	<b>106,495</b>	<b>16,895</b>	<b>-</b>	<b>158,850</b>
Liquidity gap	27,580	20,760	55,886	(60,032)	(15,869)		
Interest sensitivity gap	19,618	20,760	55,886	(60,032)	(15,869)		
Cumulative interest sensitivity gap	19,618	40,378	96,264	36,232	20,363		
Cumulative interest sensitivity gap as a percentage of total assets	10%	22%	51%	19%	11%		

Interest bearing assets include fixed interest rate bearing assets only. Interest bearing financial liabilities in part concerning "Loans from shareholders" include both fixed and variable interest rate bearing loans from shareholders in the amount of AZN 11,910 thousand and AZN 7,754 thousand respectively. Interest bearing financial liabilities in part concerning "Due to banks and other financial institutions" include both fixed and variable interest rate bearing amounts due to banks and other financial institutions in the amount of AZN 103,930 thousand and AZN 12,648 thousand respectively. Interest bearing financial liabilities in part concerning "Customer accounts" includes fixed interest rate bearing customer accounts only. For liquidity risk purposes all interest bearing financial assets and liabilities are shown in the table above according to the scheduled dates of repayment of their installments, including variable interest rate bearing financial liabilities, which are scheduled to reprice semi-annually.

	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2007 Total
<b>FINANCIAL ASSETS</b>							
Due from banks	1,736	-	-	-	-	-	1,736
Loans to customers	4,671	9,704	46,383	32,770	426	23	93,977
Investments available-for-sale	5,253	-	-	-	-	-	5,253
Investments held to maturity	-	-	-	-	-	-	-
<b>Total interest bearing financial assets</b>	<b>11,660</b>	<b>9,704</b>	<b>46,383</b>	<b>32,770</b>	<b>426</b>	<b>23</b>	<b>100,966</b>
Cash and balances with the National Bank of Azerbaijan	6,485	-	-	-	-	-	6,485
Due from banks	-	500	-	-	-	-	500
Investments available-for-sale	40	-	-	-	-	-	40
Other financial assets	51	-	-	-	-	-	51
<b>Total financial assets</b>	<b>18,236</b>	<b>10,204</b>	<b>46,383</b>	<b>32,770</b>	<b>426</b>	<b>23</b>	<b>108,042</b>
<b>FINANCIAL LIABILITIES</b>							
Loans from shareholders	81	-	4,214	6,072	-	-	10,367
Due to banks and other financial institutions	1,094	-	7,997	49,734	16,778	-	75,603
Customer accounts	1,543	1,329	3,807	1,980	-	-	8,659
<b>Total interest bearing financial liabilities</b>	<b>2,718</b>	<b>1,329</b>	<b>16,018</b>	<b>57,786</b>	<b>16,778</b>	<b>-</b>	<b>94,629</b>
Customer accounts	3,475	-	-	-	-	-	3,475
Other financial liabilities	248	-	-	-	-	-	248
<b>Total financial liabilities</b>	<b>6,441</b>	<b>1,329</b>	<b>16,018</b>	<b>57,786</b>	<b>16,778</b>	<b>-</b>	<b>98,352</b>
Liquidity gap	11,795	8,875	30,365	(25,016)	(16,352)		
Interest sensitivity gap	8,942	8,375	30,365	(25,016)	(16,352)		
Cumulative interest sensitivity gap	8,942	17,317	47,682	22,666	6,314		
Cumulative interest sensitivity gap as a percentage of total assets	8%	16%	44%	21%	6%		

A further analysis of the liquidity and interest rate risks is presented in the following tables in accordance with IFRS 7. The amounts disclosed in these tables do not correspond to the amounts recorded on the balance sheet as the presentation below includes a maturity analysis for financial liabilities that indicates the total remaining contractual payments (including interest payments), which are not recognized in the balance sheet under the effective interest rate method.

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2008 Total
<b>FINANCIAL LIABILITIES</b>								
Loans from shareholders	7.21%	-	387	5,068	17,501	667	-	23,623
Due to banks and other financial institutions	9.72%	-	1,535	10,987	108,451	26,233	-	147,206
Customer accounts	12.39%	1,852	1,485	10,334	3,817	-	-	17,488
Total interest bearing financial liabilities		1,852	3,407	26,389	129,769	26,900	-	188,317
Customer accounts		4,838	-	-	-	-	-	4,838
Other financial liabilities		756	-	-	-	-	-	756
<b>Total financial liabilities</b>		<b>7,446</b>	<b>3,407</b>	<b>26,389</b>	<b>129,769</b>	<b>26,900</b>	<b>-</b>	<b>193,911</b>

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2007 Total
<b>FINANCIAL LIABILITIES</b>								
Loans from shareholders	8.87%	-	434	4,953	6,299	-	-	11,686
Due to banks and other financial institutions	9.21%	-	449	5,581	75,944	15,901	-	97,875
Customer accounts	11.18%	1,489	1,172	4,129	2,301	-	-	9,091
Total interest bearing financial liabilities		1,489	2,055	14,663	84,544	15,901	-	118,652
Customer accounts		3,475	-	-	-	-	-	3,475
Other financial liabilities		105	143	-	-	-	-	248
<b>Total financial liabilities</b>		<b>5,069</b>	<b>2,198</b>	<b>14,663</b>	<b>84,544</b>	<b>15,901</b>	<b>-</b>	<b>122,375</b>

Weighted average effective interest rates related to “Loans from shareholders” in both 2008 and 2007 years exclude withholding tax, as shareholders have exemption from tax.

Weighted average effective interest rates related to “Due to banks and other financial institutions” in both 2008 and 2007 years include withholding tax.

## Market Risk

Market risk covers interest rate risk, currency risk and other pricing risks to which the Bank is exposed. There have been no changes as to the way the Bank measures risk or to the risk it is exposed.

The Bank is exposed to interest rate risks as entities in the Bank borrow funds at both fixed and floating rates. The risk is managed by the Bank maintaining an appropriate mix between fixed and floating rate borrowings.

The ALCO also manages interest rate and market risks by matching the Bank's interest rate position, which provides the Bank with a positive interest margin. The Department of Financial Control conducts monitoring of the Bank's current financial performance, estimates the Bank's sensitivity to changes in interest rates and its influence on the Bank's profitability.

All bank loan contracts and other financial assets as well as majority of bank's financial liabilities are fixed interest rate instruments. The Bank monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

### Interest rate sensitivity

The Bank manages fair value interest rate risk through periodic estimation of potential losses that could arise from adverse changes in market conditions. The Department of Financial Control conducts monitoring of the Bank's current financial performance, estimates the Bank's sensitivity to changes in fair value interest rates and its influence on the Bank's profitability.

The following table presents a sensitivity analysis of interest rate risk, which has been determined based on "reasonably possible changes in the risk variable". The level of these changes is determined by management and is contained within the risk reports provided to key management personnel.

Impact on profit before tax based on asset values as at 31 December 2008 and 31 December 2007:

Impact on shareholders equity:

	As at 31 December 2008		As at 31 December 2007	
	Interest rate +1%	Interest rate -1%	Interest rate +1%	Interest rate -1%
<b>Financial Assets:</b>				
Due from banks	40	(40)	17	(17)
Loans to customers	1,637	(1,637)	940	(940)
Investments available-for-sale	59	(59)	53	(53)
<b>Financial Liabilities:</b>				
Loans from shareholders	(197)	197	(104)	104
Loan from other financial institutions	(1,166)	1,166	(756)	756
Customer accounts	(170)	170	(87)	87
<b>Net impact on profit before tax</b>	<b>203</b>	<b>(203)</b>	<b>63</b>	<b>(63)</b>

This analysis is subject to the fact that semi-annual re-pricing of variable interest rate bearing financial liabilities indicated in liquidity analysis on Note 29 does not result in change of their interest rate.

### Currency risk

Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The ALCO controls currency risk by management of the open currency position on the estimated basis of AZN devaluation and other macroeconomic indicators, which gives the Bank an opportunity to minimize losses from significant currency rates fluctuations toward its national currency. The Treasury Department performs daily monitoring of the Bank's open currency position with the aim to match the requirements of National Bank of Azerbaijan.

The Bank's exposure to foreign currency exchange rate risk is presented in the table below:

	AZN	USD USD 1 = 0.801 AZN	EUR EUR 1 = 1.1292 AZN	Other currency	31 December 2008 Total
<b>Financial assets</b>					
Cash and balances with the NBA	6,088	2,881	1,072	-	10,041
Due from banks	20	6,536	588	190	7,334
Loans to customers	44,695	118,974	-	-	163,669
Investments available-for-sale	5,863	-	-	-	5,863
Investments held to maturity	125	-	-	-	125
Other financial assets	95	17	50	1	163
<b>Total financial assets</b>	<b>56,886</b>	<b>128,408</b>	<b>1,710</b>	<b>191</b>	<b>187,195</b>
<b>Financial liabilities</b>					
Loans from shareholders	-	19,664	-	-	19,664
Loans from financial institutions	8,396	108,182	-	-	116,578
Customer accounts	13,542	5,375	2,935	-	21,852
Other financial liabilities	733	18	-	5	756
<b>Total financial liabilities</b>	<b>22,671</b>	<b>133,239</b>	<b>2,935</b>	<b>5</b>	<b>158,850</b>
<b>OPEN BALANCE SHEET POSITION</b>	<b>34,215</b>	<b>(4,831)</b>	<b>(1,225)</b>	<b>186</b>	
	AZN	USD USD 1 = 0.8453 AZN	EUR EUR 1 = 1.2450 AZN	Other currency	31 December 2007 Total
<b>Financial assets</b>					
Cash and balances with the NBA	3,821	2,205	453	6	6,485
Due from banks	508	1,646	82	-	2,236
Loans to customers	13,892	80,034	51	-	93,977
Investments available-for-sale	5,293	-	-	-	5,293
Other financial assets	-	51	-	-	51
<b>Total financial assets</b>	<b>23,514</b>	<b>83,936</b>	<b>586</b>	<b>6</b>	<b>108,042</b>
<b>Financial liabilities</b>					
Loans from shareholders	-	10,367	-	-	10,367
Loans from financial institutions	4,224	71,379	-	-	75,603
Customer accounts	6,929	2,800	2,399	6	12,134
Other financial liabilities	244	4	-	-	248
<b>Total financial liabilities</b>	<b>11,397</b>	<b>84,550</b>	<b>2,399</b>	<b>6</b>	<b>98,352</b>
<b>OPEN BALANCE SHEET POSITION</b>	<b>12,117</b>	<b>(614)</b>	<b>(1,813)</b>	<b>-</b>	

### *Currency risk Sensitivity*

The following table details the Bank's Sensitivity to a 10% increase and decrease in the USD against the AZN. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency

denominated monetary items and adjusts their translation at the end of the period for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Bank where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

Impact on net profit and equity based on asset values as at 31 December 2008 and 31 December 2007:

	As at 31 December 2008		As at 31 December 2007	
	AZN/USD +10%	AZN/USD -10%	AZN/USD +10%	AZN/USD -10%
Impact on profit or loss	(483)	483	(61)	61

	As at 31 December 2008		As at 31 December 2007	
	AZN/EURO +10%	AZN/ EURO -10%	AZN/ EURO +10%	AZN/ EURO -10%
Impact on profit before tax and equity	(122)	122	(181)	181

#### Limitations of sensitivity analysis

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

The sensitivity analyses do not take into consideration that the Bank's assets and liabilities are actively managed. Additionally, the financial position of the Bank may vary at the time that any actual market movement occurs. For example, the Bank's financial risk management strategy aims to manage the exposure to market fluctuations. As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation and taking other protective action. Consequently, the actual impact of a change in the assumptions may not have any impact on the liabilities, whereas assets are held at market value on the balance sheet. In these circumstances, the different measurement bases for liabilities and assets may lead to volatility in shareholder equity.

Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Bank's view of possible near-term market changes that cannot be predicted with any certainty; and the assumption that all interest rates move in an identical fashion.

#### *Price risk*

Price risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market. The Bank is exposed to price risks of its products which are subject to general and specific market fluctuations.

The Bank manages price risk through periodic estimation of potential losses that could arise from adverse changes in market conditions and establishing and maintaining appropriate stop-loss limits and margin and collateral requirements. With respect to undrawn loan commitments the Bank is potentially exposed to a loss of an amount equal to the total amount of such commitments. However, the likely amount of a loss is less than that, since most commitments are contingent upon certain conditions set out in the loan agreements.