

Joint Stock Company Micro Finance Bank of Azerbaijan

Independent Auditors' Report

Financial Statements

For the Year Ended 31 December 2007

JOINT STOCK COMPANY MICRO FINANCE BANK OF AZERBAIJAN

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STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007

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

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Bank at 31 December 2007, 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:

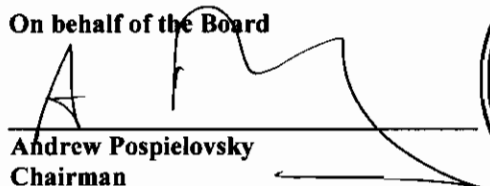
- Selecting suitable accounting principles and applying them consistently;
- Making judgements and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Preparing the financial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

Management is also responsible for:

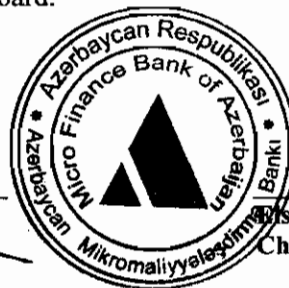
- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Bank;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Bank, and which enable them to ensure that the financial statements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

The financial statements for the year ended 31 December 2007 were authorised for issue on 31 May 2008 by the Management Board.

On behalf of the Board


Andrew Pospelovsky
Chairman

Date: 31 May 2008
City: Baku




Eshhan Hajiyev
Chief Accountant

Date: 31 May 2008
City: Baku

INDEPENDENT AUDITORS' REPORT

To the Shareholders and Supervisory Board of Joint Stock Company Micro Finance Bank of Azerbaijan:

Report on Financial Statements

We have audited the accompanying financial statements of Joint Stock Company Micro Finance Bank of Azerbaijan, which comprise the balance sheet as at 31 December 2007, and the income statement, statement of changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management responsibilities for 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' responsibilities for Financial Statements

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.

Deloitte.

Opinion

In our opinion, the financial statements present fairly, in all material respects the financial position of Joint Stock Company Micro Finance Bank of Azerbaijan as at 31 December 2007, and its financial performance and cash flows for the year ended in accordance with International Financial Reporting Standards.

Deloitte, Touche LLC

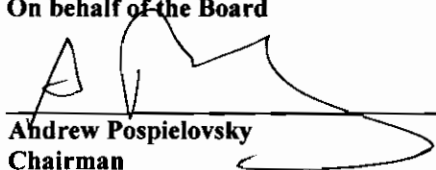
31 May 2008
Baku

JOINT STOCK COMPANY MICRO FINANCE BANK OF AZERBAIJAN

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2007

	Notes	Year ended 31 December 2007 AZN'000	Year ended 31 December 2006 AZN'000
Interest income	4, 24	20,855	7,715
Interest expense	4, 24	(6,643)	(2,357)
NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS		14,212	5,358
Provision for impairment losses on loans to customers	5	(1,111)	(422)
NET INTEREST INCOME		13,101	4,936
Net gain/(loss) on foreign exchange operations	6	54	(109)
Fee and commission income	7	1,490	634
Fee and commission expense	7	(187)	(100)
Other income		409	70
NET NON-INTEREST INCOME		1,766	495
OPERATING INCOME		14,867	5,431
OPERATING EXPENSES	8, 24	(10,055)	(5,639)
PROFIT/(LOSS) BEFORE INCOME TAX		4,812	(208)
Income tax expense	9	(1,213)	(35)
NET PROFIT/(LOSS)		3,599	(243)
EARNINGS/(LOSS) PER SHARE			
Basic (AZN)		0.37	(0.04)

On behalf of the Board


Andrew Pospelovsky
Chairman




Man Hajiyev
Chief Accountant

Date: 31 May 2008
City: Baku

Date: 31 May 2008
City: Baku

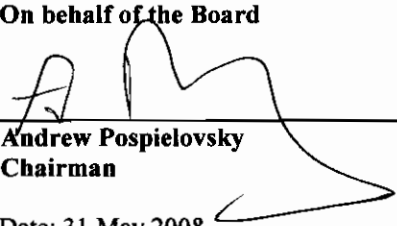
The notes on pages 9-42 form an integral part of these financial statements.

JOINT STOCK COMPANY MICRO FINANCE BANK OF AZERBAIJAN

BALANCE SHEET AS AT 31 DECEMBER 2007

	Notes	31 December 2007 AZN'000	31 December 2006 AZN'000
ASSETS			
Cash and balances with the National Bank of Azerbaijan	11	6,485	2,964
Loans and advances to banks	12, 24	2,236	2,464
Investment available-for-sale	14	5,293	40
Loans to customers	13	93,977	40,730
Property, equipment and intangible assets	15	3,576	1,596
Deferred income tax asset	9	31	84
Other assets	16	1,038	403
TOTAL ASSETS		112,636	48,281
LIABILITIES AND EQUITY			
LIABILITIES			
Loans from shareholders	17, 24	10,367	12,773
Loans from other financial institutions	18	75,603	26,247
Customer accounts	19, 24	12,134	3,274
Current income tax payable		440	-
Other liabilities	20	248	29
Total liabilities		98,792	42,323
EQUITY			
Share capital	21	11,000	6,713
Retained earnings/(accumulated deficit)		2,844	(755)
Total equity		13,844	5,958
TOTAL LIABILITIES AND EQUITY		112,636	48,281

On behalf of the Board


Andrew Pospelovsky
Chairman

Date: 31 May 2008
City: Baku




Elshan Hajiyev
Chief Accountant

Date: 31 May 2008
City: Baku


The notes on pages 9-42 form an integral part of these financial statements.

JOINT STOCK COMPANY MICRO FINANCE BANK OF AZERBAIJAN

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2007

	Share capital	Retained earnings/(accumulated deficit)	Total equity
	AZN'000	AZN'000	AZN'000
31 December 2005	6,713	(512)	6,201
Net loss	-	(243)	(243)
31 December 2006	6,713	(755)	5,958
Issue of ordinary shares	4,287	-	4,287
Net profit	-	3,599	3,599
31 December 2007	11,000	2,844	13,844

On behalf of the Board



Andrew Pospelovsky
Chairman





Elshan Hajiyev
Chief Accountant

Date: 31 May 2008
City: Baku

Date: 31 May 2008
City: Baku

The notes on pages 9-41 form an integral part of these financial statements.

JOINT STOCK COMPANY MICRO FINANCE BANK OF AZERBAIJAN

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2007

	Notes	Year ended 31 December 2007 AZN'000	Year ended 31 December 2006 AZN'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit/(loss) before income tax		4,812	(208)
Adjustments for:			
Provision for impairment losses on interest bearing assets	5	1,111	422
Depreciation and amortisation	15	664	444
Translation loss on foreign exchange operations	6	77	166
Change in interest accruals, net		520	70
Cash flows from operating activities before changes in operating assets and liabilities		7,184	894
Changes in operating assets and liabilities (Increase)/decrease in operating assets:			
Minimum reserve deposit with the National Bank of Azerbaijan		(787)	(235)
Loans and advances to banks		713	(583)
Loans to customers		(51,293)	(25,124)
Other assets		(635)	(382)
Increase/(decrease) in operating liabilities:			
Customer accounts		8,490	2,593
Loans and advances from shareholders and financial institutions		43,514	25,795
Other liabilities		221	(18)
Cash inflow from operating activities before taxation		7,407	2,940
Income tax paid		(720)	-
Net cash inflow from operating activities		6,687	2,940
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, equipment and intangible assets	15	(2,644)	(1,142)
Purchase of investments available-for-sale		(5,253)	-
Net cash outflow from investing activities		(7,897)	(1,142)
CASH FLOWS FROM FINANCING ACTIVITIES			
Issue of ordinary share capital	21	4,287	-
Net cash inflow from financing activities		4,287	-
<i>Effect of changes in foreign exchange rate on cash and cash equivalents</i>		86	(23)
NET INCREASE IN CASH AND CASH EQUIVALENTS		3,163	1,775
CASH AND CASH EQUIVALENTS, beginning of year	11	3,790	2,015
CASH AND CASH EQUIVALENTS, end of year	11	6,953	3,790

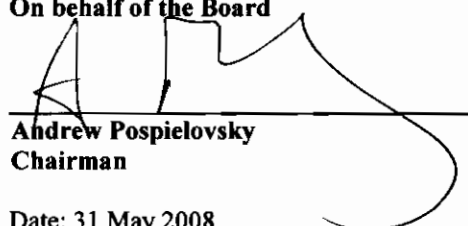
JOINT STOCK COMPANY MICRO FINANCE BANK OF AZERBAIJAN

STATEMENT OF CASH FLOWS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2007

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.

Interest paid and received by the Bank during the year ended 31 December 2006 amounted to AZN 2,033 thousand and AZN 8,040 thousand, respectively.


On behalf of the Board



Andrew Pospelovsky
Chairman

Date: 31 May 2008
City: Baku





Elshan Hajiyev
Chief Accountant

Date: 31 May 2008
City: Baku

The notes on pages 9-42 form an integral part of these financial statements.

JOINT STOCK COMPANY MICRO FINANCE BANK OF AZERBAIJAN

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007

1. ORGANISATION

Joint Stock Company Micro Finance Bank of Azerbaijan (the “Bank”) is a joint-stock bank, which was incorporated in the Azerbaijan Republic on 5 September 2002. The Bank is regulated by the National Bank of Azerbaijan (the “NBA”) and conducts its business under license number 245. 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 13 branches operating in Azerbaijan as at 31 December 2007.

As at 31 December 2007 and 2006, the following shareholders owned the issued shares of the Bank:

	31 December 2007, %	31 December 2006, %
International Finance Corporation	20.00	25.55
Black Sea Trade and Development Bank	20.00	25.55
KfW	20.00	24.96
European Bank for Reconstruction and Development	20.00	18.25
Access Holding	16.53	-
LFS Financial Systems	3.47	5.69
Total	100.00	100.00

These financial statements were authorized for issue by the Bank’s Management Board on 31 May 2008.

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 New 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 Azerbaijan law. These financial statements have been prepared from the Azerbaijan 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.

Key assumptions

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts. Such estimates and assumptions are based on the information available to the Banks's management as of the date of the financial statements. Therefore, actual results could differ from those estimates and assumptions. Estimates that are particularly susceptible to change relate to the provisions for impairment losses.

Key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial period include:

	31 December 2007 AZN' 000	31 December 2006 AZN' 000
Loans to customers	93,977	40,730
Investments available-for-sale	5,293	40

Loans to customers are measured at amortised cost less allowance for impairment losses. The estimation of allowances for impairments involves the exercise of significant judgment. The Bank estimates allowances for impairment with the objective of maintaining balance sheet provisions at a level believed by management to be sufficient to absorb losses incurred in the Bank's loan portfolio. The calculation of provisions on impaired loans is based on the likelihood of the asset being written off and the estimated loss on such a write-off. These assessments are made using statistical techniques based on historic experience. These determinations are supplemented by the application of management judgment.

The Bank considers accounting estimates related to provisions for loans key sources 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 losses relating to impaired loans and advances are based on recent performance experience, and (ii) any significant difference between the Bank's estimated losses (as reflected in the provisions) and actual losses will require the Bank to take provisions which, if significantly different, could have a material impact on its future income statement and its balance sheet. The Bank's assumptions about estimated losses are based on past performance, past customer behaviour, the credit quality of recent underwritten business and general economic conditions, which are not necessarily an indication of future losses.

Investments into equity securities available-for-sale are measured at cost less impairment losses. The estimation of impairment losses involves the exercise of significant management judgment. The accounting policy for the impairment of financial instruments is discussed in Note 3 below.

Functional currency

The functional currency of these financial statements is the New Azerbaijan Manat ("AZN").

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 obligation of the instrument. Regular way purchase and sale of the 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.

Loans and advances to banks

In the normal course of business, the Bank maintains advances or deposits for various periods of time with other banks. Loans and advances to banks with a fixed maturity term are subsequently measured at amortized cost using the effective interest method. 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 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 these 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 allowance for impairment losses in case of uncollectibility of loans and advances, including through repossession of collateral. 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.

Allowance for impairment losses

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, for financial assets which are carried at amortized cost. 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, the previously recognized impairment loss is reversed. For financial assets carried at cost, the 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.

Investments available-for-sale

Investments available-for-sale represent debt and equity investments that are intended to be held for an indefinite period of time. Such securities are initially recorded at fair value. Subsequently the securities are measured at fair value, with such re-measurement recognized directly in equity until sold when gain/loss previously recorded in equity recycles through the income statement, 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. 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 a valuation technique. 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 other applicable methods. 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. Dividends received are included in other income in the income statement.

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 carried at historical cost less accumulated depreciation. Depreciation of property, equipment and intangible assets is charged on the carrying value of those assets and is designed to write off assets over their useful economic lives. It is calculated on a straight line basis at the following annual prescribed rates:

Buildings and other real estate	10%-20%
Computers	25%
Furniture and office equipment	25%
Vehicles	25%
Intangible assets	20%

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, and where carrying values exceed this estimated recoverable amount, assets are written down to their recoverable amount.

Impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation 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 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.

Loans from banks and other institutions and customer accounts

Loans from banks and other 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.

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 International Accounting Standard 10 “Events after the Balance Sheet Date” (“IAS 10”) and disclosed accordingly.

Recognition of 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.

Interests earned on assets at fair value are classified within interest income.

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. 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/(loss) on foreign exchange operations.

Rates of exchange

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

	31 December 2007 AZN`000	31 December 2006 AZN`000
AZN/1 US Dollar	0.8453	0.8714
AZN/1 Euro	1.2450	1.1471

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 derecognition, the Bank does not offset the transferred asset and the associated liability.

Adoption of new 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 reporting periods beginning on 1 January 2007. 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 except for the effect of application of IFRS 7 "Financial Instruments: Disclosure" ("IFRS 7").

IFRS 7 is effective for the annual period beginning on or after 1 January 2007. IFRS 7 establishes new requirements and recommendations on financial instrument disclosure. Adoption of IFRS 7 did not affect the classification and measurement of Bank's financial instruments in the financial statements. Additional information was disclosed in the financials statements for the current and comparative reporting periods as required by IFRS 7.

4. NET INTEREST INCOME

	Year ended 31 December 2007 AZN'000	Year ended 31 December 2006 AZN'000
Interest income comprises:		
Interest income on assets recorded at amortized cost:		
- interest income on unimpaired assets	20,760	7,699
Interest income on investments available-for-sale	<u>95</u>	<u>16</u>
Total interest income	<u>20,855</u>	<u>7,715</u>
Interest income on assets recorded at amortized cost comprises:		
Interest on loans to customers	20,355	7,417
Interest on loans and advances to banks	<u>405</u>	<u>282</u>
Total interest income on financial assets recorded at amortized cost	<u>20,760</u>	<u>7,699</u>
Interest income on investments available-for-sale	<u>95</u>	<u>16</u>
Total interest income	<u>20,855</u>	<u>7,715</u>
Interest expense comprises:		
Interest expense on liabilities recorded at amortized cost comprise:		
Interest on customer accounts	(466)	(109)
Interest on borrowings from shareholders and financial institutions	<u>(6,177)</u>	<u>(2,248)</u>
Total interest expense	<u>(6,643)</u>	<u>(2,357)</u>
Net interest income before provision for impairment losses on interest bearing assets	<u>14,212</u>	<u>5,358</u>

5. ALLOWANCE FOR IMPAIRMENT LOSSES

The movements in allowance for impairment losses on loans to customers were as follows:

	2007 AZN'000	2006 AZN'000
At the beginning of the year	<u>857</u>	<u>708</u>
Provision	1,111	422
Write-off of assets	-	(308)
Recoveries of assets previously written off	<u>19</u>	<u>35</u>
At the end of the year	<u>1,987</u>	<u>857</u>

6. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain/ (loss) on foreign exchange operations comprises:

	Year ended 31 December 2007 AZN'000	Year ended 31 December 2006 AZN'000
Dealing, net	131	57
Translation differences, net	<u>(77)</u>	<u>(166)</u>
Total net gain/(loss) on foreign exchange operations	<u>54</u>	<u>(109)</u>

7. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	Year ended 31 December 2007 AZN'000	Year ended 31 December 2006 AZN'000
Fee and commission income:		
Cash operations	1,274	561
Settlements	133	51
Plastic cards operations	26	-
Foreign exchange operations	44	7
Other	<u>13</u>	<u>15</u>
Total fee and commission income	<u>1,490</u>	<u>634</u>
Fee and commission expense:		
Plastic card services	(12)	-
Cash operations	(144)	(86)
Settlements	(30)	(14)
Other	<u>(1)</u>	<u>-</u>
Total fee and commission expense	<u>(187)</u>	<u>(100)</u>
Total net fee and commission income	<u>1,303</u>	<u>534</u>

8. OPERATING EXPENSES

Operating expenses comprise:

	Year ended 31 December 2007 AZN'000	Year ended 31 December 2006 AZN'000
Staff costs	4,428	2,072
Unified social tax	929	452
Management services	904	994
Rental of premises	718	367
Depreciation and amortization	664	444
Printing and office supplies	576	218
Advertising	449	242
Repair and maintenance	332	168
Communication	324	193
Security	237	113
Professional fees	105	95
Utilities	76	48
Taxes other than income tax	20	10
Other operating expenses	293	223
Total	10,055	5,639

During the years ended 31 December 2007 and 2006 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 the country where the Bank operates and which may differ from International Financial Reporting Standards.

The Bank is subject to certain permanent tax differences due to 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 2007 and 2006 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 2007 and 2006 comprise:

	31 December 2007 AZN'000	31 December 2006 AZN'000
Deductible temporary differences:		
Other liabilities	196	-
Property, equipment and intangible assets	-	8
Tax loss carry forward reversal	-	374
	<u>196</u>	<u>382</u>
Total deductible temporary differences	196	382
Taxable temporary differences:		
Property, plant and equipment	(54)	-
	<u>(54)</u>	<u>-</u>
Total taxable temporary differences	(54)	-
Net deferred deductible temporary differences	142	382
	<u>142</u>	<u>382</u>
Net deferred tax asset at the statutory tax rate (22%)	31	84

Relationships between tax expenses and accounting profit/(loss) for the years ended 31 December 2007 and 2006 are explained as follows:

	Year ended 31 December 2007 AZN'000	Year ended 31 December 2006 AZN'000
Profit/(loss) before income tax	4,812	(208)
	<u>4,812</u>	<u>(208)</u>
Tax at the statutory tax rate (22%)	1,059	(46)
Tax effect of permanent differences	154	81
	<u>1,213</u>	<u>35</u>
Income tax expense	1,213	35
Current income tax expense	1,160	-
Change in the deferred tax assets	53	35
	<u>1,213</u>	<u>35</u>
Income tax expense	1,213	35
	<u>1,213</u>	<u>35</u>
Deferred income tax assets	31 December 2007 AZN'000	31 December 2006 AZN'000
Beginning of the year	84	119
Change in the income tax asset for the period charged to profit	(53)	(35)
	<u>(53)</u>	<u>(35)</u>
End of the year	31	84
	<u>31</u>	<u>84</u>

10. EARNINGS/(LOSS) PER SHARE

	Year ended 31 December 2007 AZN'000	Year ended 31 December 2006 AZN'000
Profit:		
Net profit/(loss) for the year	3,599	(243)
Weighted average number of ordinary shares for basic earnings per share	9,837,225	6,713,370
Earnings/(loss) per share (AZN)	0.37	(0.04)

11. CASH AND BALANCES WITH THE NATIONAL BANK OF AZERBAIJAN

	31 December 2007 AZN'000	31 December 2006 AZN'000
Cash	4,700	2,150
Balances with the National Bank of Azerbaijan	1,785	814
Total cash and balances with the National Bank of Azerbaijan	6,485	2,964

The balances with the National Bank of Azerbaijan as at 31 December 2007 and 2006 include AZN 1,083 thousand and AZN 296 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:

	31 December 2007 AZN'000	31 December 2006 AZN'000
Cash and balances with the National Bank of Azerbaijan	6,485	2,964
Loans and advances to banks in OECD countries	1,551	1,122
Total	8,036	4,086
Less minimum reserve deposits and foreign currency deposits with the National Bank of Azerbaijan	(1,083)	(296)
Total cash and cash equivalents	6,953	3,790

12. LOANS AND ADVANCES TO BANKS

	31 December 2007 AZN'000	31 December 2006 AZN'000
Correspondent accounts with other banks	1,728	1,597
Loan to bank	508	867
Total loans and advances to banks	2,236	2,464

As at 31 December 2007 and 2006 the Bank had loans and advances to 1 and 2 banks, respectively, which individually exceeded 10 % of the Bank's equity.

As at 31 December 2007 and 2006 the maximum credit risk exposure on loans and advances to banks amounted to AZN 2,236 thousand and AZN 2,464 thousand, respectively.

13. LOANS TO CUSTOMERS

	31 December 2007 AZN'000	31 December 2006 AZN'000
Loans to customers	95,964	41,587
Less allowance for impairment losses	<u>(1,987)</u>	<u>(857)</u>
Total loans to customers	<u>93,977</u>	<u>40,730</u>

Movements in allowances for impairment losses for the years ended 31 December 2007 and 2006 are disclosed in Note 5.

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

	31 December 2007 AZN'000	31 December 2006 AZN'000
Loans collateralized by real estate	48,916	23,376
Loans collateralized by combined collateral (inventory and equipment)	36,917	16,405
Other collateral	9,051	1,450
Unsecured loans	<u>1,080</u>	<u>356</u>
Totals	95,964	41,587
Less allowance for impairment losses	<u>(1,987)</u>	<u>(857)</u>
Total loans to customers	<u>93,977</u>	<u>40,730</u>

	31 December 2007 AZN'000	31 December 2006 AZN'000
Analysis by sector:		
Trade	58,291	28,585
Services	9,079	3,801
Manufacturing	9,817	3,556
Retail	9,784	2,253
Communication	4,316	1,243
Agriculture	3,391	471
Construction	246	296
Other	<u>1,040</u>	<u>1,382</u>
Totals	95,964	41,587
Less allowance for impairment losses	<u>(1,987)</u>	<u>(857)</u>
Total loans to customers	<u>93,977</u>	<u>40,730</u>

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 Azerbaijan Republic, which represents significant geographical concentration in one region.

As at 31 December 2007 and 2006 a maximum credit risk exposure on loans to customers amounted to AZN 93,977 thousand and AZN 40,730 thousand, respectively.

As at 31 December 2007 and 2006 loans to customers included loans in amount of AZN 3,563 thousand and AZN 1,090 thousand, respectively, that were individually determined to be impaired. As at 31 December 2007 and 2006 such loans were collateralized by property with a fair value of AZN 1,274 thousand and AZN 937 thousand, respectively.

14. INVESTMENTS AVAILABLE-FOR-SALE

Investments available-for-sale comprise:

	31 December 2007 AZN'000	31 December 2006 AZN'000
Debt securities	5,253	-
Equity securities	40	40
Total investments available-for-sale	5,293	40

	Interest to nominal %	31 December 2007 AZN'000	Interest to nominal %	31 December 2006 AZN'000
Debt securities				
NBA notes No. 50100618S	11.15	459	-	-
NBA notes No. 50100718S	11.28	951	-	-
NBA notes No. 50100818S	6.80	3,843	-	-
		<u>5,253</u>		<u>-</u>

	Ownership interest	31 December 2007 AZN'000	Ownership interest	31 December 2006 AZN'000
Equity securities				
Milli Card LLP	1%	40	1%	40
Total investments available-for-sale		5,293		40

15. PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS

	Buildings and other real estate AZN'000	Furniture and office equipment AZN'000	Computers AZN'000	Vehicles AZN'000	Intangible assets AZN'000	Total AZN'000
At initial cost						
31 December 2005	738	524	211	68	53	1,594
Additions	<u>380</u>	<u>588</u>	<u>127</u>	<u>12</u>	<u>35</u>	<u>1,142</u>
31 December 2006	<u>1,118</u>	<u>1,112</u>	<u>338</u>	<u>80</u>	<u>88</u>	<u>2,736</u>
Additions	1,865	417	292	34	36	2,644
Transfers	<u>-</u>	<u>(83)</u>	<u>83</u>	<u>-</u>	<u>-</u>	<u>-</u>
31 December 2007	<u>2,983</u>	<u>1,446</u>	<u>713</u>	<u>114</u>	<u>124</u>	<u>5,380</u>
Accumulated depreciation						
31 December 2005	354	219	91	16	16	696
Charge for the year	<u>182</u>	<u>169</u>	<u>63</u>	<u>17</u>	<u>13</u>	<u>444</u>
31 December 2006	<u>536</u>	<u>388</u>	<u>154</u>	<u>33</u>	<u>29</u>	<u>1,140</u>
Charge for the year	226	270	122	23	23	664
Transfers	<u>-</u>	<u>(41)</u>	<u>41</u>	<u>-</u>	<u>-</u>	<u>-</u>
31 December 2007	<u>762</u>	<u>617</u>	<u>317</u>	<u>56</u>	<u>52</u>	<u>1,804</u>
Net book value						
31 December 2007	<u>2,221</u>	<u>829</u>	<u>396</u>	<u>58</u>	<u>72</u>	<u>3,576</u>
31 December 2006	<u>582</u>	<u>724</u>	<u>184</u>	<u>47</u>	<u>59</u>	<u>1,596</u>

As at 31 December 2007 and 2006 included in property, equipment and intangible assets were fully depreciated and amortized assets in of AZN 184 thousands and AZN 193 thousands, respectively.

16. OTHER ASSETS

	31 December 2007 AZN'000	31 December 2006 AZN'000
Prepaid rent expenses	244	247
Collateral repossessed	83	83
Settlements with money transfer systems	52	66
Prepayments on property, equipment and intangible assets	659	7
	<u>1,038</u>	<u>403</u>
Total other assets	<u>1,038</u>	<u>403</u>

17. LOANS FROM SHAREHOLDERS

	31 December 2007 AZN'000	31 December 2006 AZN'000
European Bank for Reconstruction and Development	4,258	4,385
KfW	3,674	4,319
International Finance Corporation	1,561	2,277
Black Sea Trade and Development Bank	874	1,792
	<u>10,367</u>	<u>12,773</u>
Total loans from shareholders	<u>10,367</u>	<u>12,773</u>

On 6 October 2003 the Bank signed a loan agreement with European Bank for Reconstruction and Development to the amount of USD 5,000,000. The loan bears market interest per annum. Principal is to be repaid starting from 14 May 2008 in 4 equal semi-annual installments. Interest is paid on the same dates.

On 30 March 2006 the Bank signed a loan agreement with KfW to the amount of USD 5,000,000. 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 6 July 2005 the Bank signed a loan agreement with International Finance Corporation to the amount of USD 3,000,000. 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 19 August 2005 the Bank signed a loan agreement with Black Sea Trade and Development Bank to the amount of USD 3,000,000. The loan bears market interest per annum. Principal is to be repaid starting from 18 February 2006 in six equal semi-annual installments. Interest is paid on the same dates.

18. LOANS FROM OTHER FINANCIAL INSTITUTIONS

	31 December 2007 AZN'000	31 December 2006 AZN'000
Blueorchard Loans for Development	10,193	3,491
Developing World Markets Securitizations S.A. acting on behalf of its Compartment MFBA BOND I	9,780	-
Deutsche Bank Aktiengesellschaft	8,610	-
Triodos International Fund Management	5,461	3,026
Dexia Micro-Credit Fund	4,295	3,499
Organization of the Petroleum Exporting Countries Fund for International Development	4,238	-
Pettelaar Effectenbewaarbedrijf N.V.	4,224	-
Swiss Investment Fund for Emerging Markets	3,370	-
Global Commercial Microfinance Consortium, Ltd.	3,364	3,457
Asian Development Bank	3,045	3,538
Triple Jump B.V.	2,609	-
Microfinance Loan Obligations S.A.	2,597	-
Global Microfinance Facility	2,578	2,659
VDK Spaarbank NV	2,554	-
ResponsAbility SICAV (Luxembourg)	2,204	-
Oikocredit Ecumenical Development Cooperative Society U.A.	1,772	2,187
Developing World Markets Securitization S.A.	1,690	1,737
Impulse Microfinance Investment Fund	1,492	1,098
Dual return Fund S.I.C.A.V.	1,273	1,312
Vantage Mutual Fund	254	243
	<hr/>	<hr/>
Total loans from other financial institutions	75,603	26,247

On 15 December 2006 the Bank signed a loan agreement with ResponsAbility SICAV (Lux) (registered in Luxembourg) to the amount of USD 2,500,000. The loan bears market interest rate per annum. Principal is to be repaid on maturity, which is 15 January 2010. Interest is paid starting from 15 July 2007 by six instalments.

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 3,000,000. The loan bears market interest rate per annum. Principal is to be repaid in 2 instalments 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 2,000,000. The loan bears market interest rate per annum. Principal is to be repaid in two instalments on 26 February 2009 and 26 February 2010, which is the maturity date. Interest is paid starting from 26 August 2007 in six (6) semi-annual instalments.

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 3,000,000. 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 5,000,000. The loan bears market interest rate per annum. Principal is to be repaid in nine (9) approximately equal semi-annual instalments by maturity, which is 1 June 2012. Interest is paid starting from 1 December 2007 in semi-annual instalments.

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 2,000,000. 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 02 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 2,500,000. 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 23 April 2007 the Bank signed a loan agreement with VDK Spaarbank n.v. (registered in Belgium) to the amount of USD 3,000,000. 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 31 May 2007 the Bank signed a loan agreement with BlueOrchard Loans for Development S.A. (registered in Luxembourg) to the amount of USD 8,000,000. 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 7,400,000 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 11,400,000. The loan bears market interest rate per annum. Principal is to be repaid in four (4) instalments starting from 24 February 2011 by the maturity date which is 28 August 2012. Interest is paid in ten (10) instalments starting from 28 February 2008.

On 13 November 2007 the Bank signed a loan agreement with Pettelaar Effectenbewaarbedrijf N.V to the amount equal to USD 5,000,000 in Azerbaijan New 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 6,000,000. As at 31 December 2007 the Bank had used USD 4,000,000 of the above limit. The loan bears market interest rate per annum. Principal is to be repaid in eight (8) equal instalments starting from 7 January 2010 by maturity, which is 7 January 2014. Interest is paid starting from 31 March 2008 semi-annually.

19. CUSTOMER ACCOUNTS

Customer accounts comprise:

	31 December 2007 AZN'000	31 December 2006 AZN'000
Time deposits	8,557	2,273
Demand deposits	3,270	833
Blocked accounts	307	168
	<hr/>	<hr/>
Total customer accounts	12,134	3,274

	31 December 2007 AZN'000	31 December 2006 AZN'000
Analysis by sector:		
Individuals	9,909	3,004
Trade	1,313	65
Insurance	912	192
Other	-	13
	<hr/>	<hr/>
Total customer accounts	12,134	3,274

20. OTHER LIABILITIES

Other liabilities comprise:

	31 December 2007 AZN'000	31 December 2006 AZN'000
Accrued staff costs	143	-
Accrued professional fees	76	-
Settlements with money transfer systems	29	29
	<hr/>	<hr/>
Total other liabilities	248	29

21. SHARE CAPITAL

As of 31 December 2007 and 2006 the authorized, issued and paid-in share capital consisted of 11,000,000 and 6,713,370 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 2007 and 2006:

	Ordinary shares AZN'000
31 December 2005	1,370,000
Re-denomination of shares	<u>5,343,370</u>
31 December 2006	6,713,370
Issue of shares	<u>4,286,630</u>
31 December 2007	<u><u>11,000,000</u></u>

On 20 December 2006 the Bank re-denominated the par value of shares from USD 5 to 1 AZN each.

On 9 April 2007 the shareholders approved an increase in share capital of AZN 4,287 thousand.

22. 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 Banks'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's 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 2007 and 2006 the nominal or contract amounts were:

	31 December 2007 AZN'000	31 December 2006 AZN'000
Guarantees issued and similar commitments	<u>269</u>	<u>-</u>
Total contingent liabilities and credit commitments	<u><u>269</u></u>	<u><u>-</u></u>

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 Azerbaijani tax legislation 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 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.

Operating environment – The Bank’s principal business activities are within the Azerbaijan Republic. Laws and regulations affecting the business environment in the Azerbaijan Republic 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.

23. SUBSEQUENT EVENTS

On 8 February 2008 the Bank signed a loan agreement with Oikocredit (registered in the Netherlands) to the amount of USD 2,500,000. The loan bears market interest rate per annum. Principal is to be repaid in seven (7) equal semi-annual instalments starting from 27 February 2009. Interest is paid semi-annually starting from 27 August 2008.

On 11 February 2008 the Bank signed a loan agreement with Dexia Micro-Credit Fund (registered in Luxembourg) to the amount of USD 5,000,000. The loan bears market interest rate per annum. Principal is to be repaid in two instalments on 11 February 2010 and 11 February 2011, which is the maturity date. Interest is paid semi-annually starting from 11 August 2008.

Under the term loan facility agreement dated 29 August 2007 with DWM Securitizations S.A. (registered in Luxembourg) acting on behalf of its Compartment MFBA BOND I on 3 March 2008 the Bank received the second tranche in the amount of USD 13,600,000. The loan bears market interest rate per annum. Principal is to be repaid in four (4) instalments starting from 24 February 2011 by the maturity date which is 28 August 2012. Interest is paid in nine (9) instalments starting from 28 August 2008.

On 17 April 2008 subscription agreements were signed by all the shareholders to increase the share capital of the bank by AZN 9 million, from AZN 11 million to AZN 20 million. All shareholders are participating in the capital increase in proportion to their previous ownership share in the bank and thus the ownership structure of Bank remains unchanged.

24. 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); or
- (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. The Bank had the following transactions outstanding with related parties:

	31 December 2007 AZN'000		31 December 2006 AZN'000	
	Related party balances	Total category as per financial statements caption	Related party balances	Total category as per financial statements caption
Loans to customers, net	40	93,977	-	40,730
Loans from shareholders	10,367	10,367	12,773	12,773
Customer accounts	302	12,134	-	3,274

Included in the income statement for the years ended 31 December 2007 and 2006 are the following amounts which arose due to transactions with related parties:

	31 December 2007 AZN'000		31 December 2006 AZN'000	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Key management personnel compensation:				
Local staff	218	4,428	57	2,072
LFS (payment for Management Services Contract which includes gross salaries)	904	904	994	994

	Year ended 31 December 2007 AZN'000		Year ended 31 December 2006 AZN'000	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Interest income	2	20,855	-	7,715
Interest expense		6,643		2,357
- <i>shareholders</i>	1,185		1,127	
- <i>key management personnel</i>	18		-	

25. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments are made in accordance with the requirements of IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement". 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 2007 AZN'000		31 December 2006 AZN'000	
	Carrying value	Fair value	Carrying value	Fair value
Cash and balances with the National Bank of Azerbaijan	6,485	6,485	2,964	2,964
Loans and advances to banks	2,236	2,236	2,464	2,464
Investment available-for-sale	5,293	5,293	40	40
Loans from shareholders	10,367	10,367	12,773	12,773
Loans from other financial institutions	75,603	75,603	26,247	26,247
Customer accounts	12,134	12,134	3,274	3,274

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.

26. 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 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.

As at 31 December 2006 the Bank's total capital amount for Capital Adequacy purposes was AZN 5,958 thousand and tier 1 capital amount was AZN 5,958 thousand with ratio of 13.30 % and 13.30 %, 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 2007 and 2006 the Bank was in compliance with the minimum capital requirements imposed by the NBA.

27. CAPITAL MANAGEMENT

The Bank manages its capital to ensure that entity will be able to continue as a going concern while maximising the return to shareholders through the optimisation of the debt and equity balance.

The capital structure of the Bank consists of debt, which includes subordinated debt disclosed in Note 18, and equity attributable to equity holders, 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 2006.

28. 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 risk
- 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 risks 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 Departments and Branch

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 but a significant portion is personal lending, where no such facilities can be obtained. 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 a probability of losses due to the inability of 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 Banks 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 financial assets and contingent liabilities. For financial assets the maximum exposure equals to a carrying value of those assets prior to any offset or collateral. For financial guarantees and other contingent liabilities 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.

	Maximum exposure AZN'000	Offset AZN'000	Net exposure after offset AZN'000	Collateral Pledged AZN'000	31 December 2007 Net exposure after offset and collateral AZN'000
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

	Maximum exposure AZN'000	Offset AZN'000	Net exposure after offset AZN'000	Collateral Pledged AZN'000	31 December 2006 Net exposure after offset and collateral AZN'000
Loans and advances to banks	2,464	-	2,464	-	2,464
Loans to customers	40,730	78	40,652	47,074	-
Investments available-for-sale	40	-	40	-	40

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:

							31	
	AAA	AA	A	BBB	>BBB	Not rated	December 2007	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	
							31	
							December 2006	Total
	AAA	AA	A	BBB	>BBB	Not rated		
Loans and advances to banks	-	1,122	-	-	3	1,339	2,464	
Loans to customers	-	-	-	-	-	40,730	40,730	
Investments available-for-sale	-	-	-	-	-	40	40	

The banking industry is generally exposed to credit risk through its financial assets and contingent liabilities. Credit risk exposure of the Bank is concentrated within Azerbaijan. 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:

	Neither past due nor impaired	Financial assets past due but not impaired				31 December 2007	Financial assets that have been impaired	Total
		0-3 months	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	
							31 December 2006	
							Financial assets that have been impaired	Total
	Neither past due nor impaired	0-3 months	3-6 months	6 months to 1 year	Greater than one year			
Loans and advances to banks	2,464	-	-	-	-	-	2,464	
Loans to customers	4,726	-	-	-	-	36,004	40,730	
Investments available-for-sale	40	-	-	-	-	-	40	

Geographical concentration

The ALMC 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 Azerbaijan.

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

	Azerbaijan	Other non-OECD countries	OECD countries	31 December 2007 Total
ASSETS				
Cash and balances with the National Bank of Azerbaijan	6,485	-	-	6,485
Loans and advances to banks	594	91	1,551	2,236
Investments available-for-sale	5,293	-	-	5,293
Loans to customers	93,977	-	-	93,977
Property, equipment and intangible assets	3,576	-	-	3,576
Deferred income tax asset	31	-	-	31
Other assets	952	-	86	1,038
TOTAL ASSETS	110,908	177	1,551	112,636
LIABILITIES				
Loans from shareholders	-	-	10,367	10,367
Loan from other financial institutions	-	3,045	72,558	75,603
Customer accounts	12,134	-	-	12,134
Current income tax payable	440	-	-	440
Other liabilities	244	-	4	248
TOTAL LIABILITIES	12,818	3,045	82,929	98,792
NET POSITION	98,090	(2,868)	(81,378)	
	Azerbaijan	Other non-OECD countries	OECD countries	31 December 2006 Total
ASSETS				
Cash and balances with the National Bank of Azerbaijan	2,964	-	-	2,964
Loans and advances to banks	1,071	271	1,122	2,464
Investments available-for-sale	40	-	-	40
Loans to customers	40,730	-	-	40,730
Property, equipment and intangible assets	1,596	-	-	1,596
Deferred income tax asset	84	-	-	84
Other assets	403	-	-	403
TOTAL ASSETS	46,888	271	1,122	48,281
LIABILITIES				
Loans from shareholders	-	-	12,773	12,773
Loan from other financial institutions	-	9,715	16,532	26,247
Customer accounts	3,274	-	-	3,274
Other liabilities	29	-	-	29
TOTAL LIABILITIES	3,303	9,715	29,305	42,323
NET POSITION	43,585	(9,444)	(28,183)	

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 Assets and Liabilities Management Committee (“ALMC”) 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 optimisation.

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 tables have been drawn up to detail:

(i) The remaining contractual maturity of non-derivative financial liabilities based on the undiscounted cash flows of financial liabilities (both interest and principal cash flows) based on the earliest date on which the Bank can be required to pay, and

(ii) The expected maturity for non-derivative financial assets based on the undiscounted contractual maturities of the financial assets including interest that will be earned on those assets except where the Bank anticipates that the cash flow will occur in a different period.

	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	31 December 2007 Total
ASSETS							
Loans and advances to banks	2.92%	14	500	-	-	-	514
Loans to customers	30.86%	11,635	19,770	56,983	27,072	151	115,611
Investments available-for-sale	8.03%	5,270	-	-	-	-	5,270
Total interest bearing assets at fixed rates		16,919	20,270	56,983	27,072	151	121,395
Total interest bearing assets		16,919	20,270	56,983	27,072	151	121,395
Cash and balances with NBA		6,485	-	-	-	-	6,485
Loans and advances to banks		1,728	-	-	-	-	1,728
Other assets		52	-	-	83	-	135
TOTAL ASSETS		25,184	20,270	56,983	27,155	151	129,743
LIABILITIES							
Loans from other financial institutions	9.09%	-	-	1,148	60,065	15,901	77,114
Customer accounts	11.18%	1,489	1,172	4,129	2,301	-	9,091
Total interest bearing liabilities at fixed rates		1,489	1,172	5,277	62,366	15,901	86,205
Loans from shareholders	8.87%	-	434	4,953	6,299	-	11,686
Loan from other financial institutions	9.33%	-	449	4,433	15,879	-	20,761
Total interest bearing liabilities at variable rates		-	883	9,386	22,178	-	32,447
Total interest bearing liabilities		1,489	2,055	14,663	84,544	15,901	118,652
Customer accounts		3,577	-	-	-	-	3,577
Income tax payable		440	-	-	-	-	440
Other liabilities		29	143	-	-	-	172
TOTAL LIABILITIES		5,535	2,198	14,663	84,544	15,901	122,841
Liquidity gap		19,649	18,072	42,320	(57,389)	(15,750)	
Interest sensitivity gap for fixed rate instruments		15,430	19,098	51,706	(35,294)	(15,750)	
Interest sensitivity gap for floating rate instruments		-	(883)	(9,386)	(22,178)	-	
Interest sensitivity gap		15,430	18,215	42,320	(57,472)	(15,750)	
Cumulative interest sensitivity gap		15,430	33,645	75,965	18,493	2,743	

	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	31 December 2006 Total
ASSETS							
Loans and advances to banks	12.21%	-	884	-	-	-	884
Loans to customers	29.74%	3,451	7,716	25,081	11,714	139	48,101
Total interest bearing assets at fixed rates		3,451	8,600	25,081	11,714	139	48,985
Total interest bearing assets		3,451	8,600	25,081	11,714	139	48,985
Cash and balances with NBA		2,964	-	-	-	-	2,964
Loans and advances to banks		1,597	-	-	-	-	1,597
Other assets		66	-	-	83	-	149
TOTAL ASSETS		8,078	8,600	25,081	11,797	139	53,695
LIABILITIES							
Loans from other financial institutions	8.91%	-	21	1,019	16,582	408	18,030
Customer accounts	8.70%	136	399	1,453	400	-	-
Total interest bearing liabilities at fixed rates		136	420	2,472	16,982	408	20,418
Loans from shareholders	9.95%	124	443	1,694	12,687	-	14,948
Loan from other financial institutions	9.59%	1	-	2,965	12,984	-	15,950
Total interest bearing liabilities at variable rates		125	443	4,659	25,671	-	30,898
Total interest bearing liabilities		261	863	7,131	42,653	408	51,316
Customer accounts		1,001	-	-	-	-	1,001
Other liabilities		29	-	-	-	-	29
TOTAL LIABILITIES		1,291	863	7,131	42,653	408	52,346
Liquidity gap		6,787	7,737	17,950	(30,856)	(269)	
Interest sensitivity gap for fixed rate instruments		3,315	8,180	22,609	(5,268)	(269)	
Interest sensitivity gap for floating rate instruments		(125)	(443)	(4,659)	(25,671)	-	
Interest sensitivity gap		3,190	7,737	17,950	(30,939)	(269)	
Cumulative interest sensitivity gap		3,190	10,927	28,877	(2,062)	(2,331)	

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 in 2007.

The ALMC 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.

Interest rate risk

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 and shareholders' equity:

	As at 31 December 2007		As at 31 December 2006	
	Interest rate +1%	Interest rate -1%	Interest rate +1%	Interest rate -1%
Assets:				
Loans and advances to banks	-	-	-	-
Loans to customers	-	-	-	-
Investments available-for-sale	-	-	-	-
Liabilities:				
Loans from shareholders	(104)	104	(128)	128
Loan from other financial institutions	(174)	174	(130)	130
Customer accounts	-	-	-	-
Net impact on profit before tax	(278)	278	(258)	258

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 ALMC 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 NBA.

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

	AZN	USD USD 1 = 0.8453 AZN	EUR EUR 1 = 1.2450 AZN	Other currency	31 December 2007 Total
ASSETS					
Cash and balances with the National Bank of Azerbaijan	3,821	2,205	453	6	6,485
Loans and advances to banks	508	1,646	82	-	2,236
Investments available-for-sale	5,293	-	-	-	5,293
Loans to customers	13,892	80,034	51	-	93,977
Property, equipment and intangible assets	3,576	-	-	-	3,576
Deferred income tax asset	31	-	-	-	31
Other assets	952	86	-	-	1,038
TOTAL ASSETS	28,073	83,971	586	6	112,636
LIABILITIES					
Loans from shareholders	-	10,367	-	-	10,367
Loan from other financial institutions	4,224	71,379	-	-	75,603
Customer accounts	6,929	2,800	2,399	6	12,134
Current income tax payable	440	-	-	-	440
Other liabilities	244	4	-	-	248
TOTAL LIABILITIES	11,837	84,550	2,399	6	98,792
OPEN BALANCE SHEET POSITION	16,236	(579)	(1,813)	-	